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11 November 2019

David Bradbury, Head
Tax Policy and Statistics Division
Centre for Tax Policy and Administration
Organisation for Economic Co-Operation
and Development
Paris, France

Via email: TFDE@oecd.org

RE: TEI Comments on the Secretariat's "Unified Approach" under Pillar One

Dear Mr. Bradbury:

The OECD launched its base erosion and profit shifting (BEPS) project in 2013. Action 1 of the BEPS project was entitled *Addressing the Tax Challenges of the Digital Economy* and the OECD published a final report under that action on 5 October 2015 (the Final Report).[1] The Final Report concluded in part "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."[2] The Final Report noted that the OECD would continue to monitor developments in this area, along with implementation of the other BEPS actions, with a view toward producing a follow-up report on the digital economy in 2020.[3]

Subsequent developments and substantial political pressure, however, have overtaken the "wait and see" approach anticipated by the Final Report. Thus, following the Final Report the OECD has published: (i) an interim report entitled *Tax Challenges Arising from Digitalisation* in March 2018; (ii) a policy note, entitled *Addressing the Tax Challenges of the Digitalisation of the Economy* on 23 January 2019; (iii) a public consultation document, also entitled *Addressing the Tax Challenges of the Digitalisation of the Economy*, on 13 February 2019; (iv) a document entitled *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the*

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1 The Final Report is available at https://www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm.

2 Final Report at 11 & 54.

3 *Id*. at 138.

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Digitalisation of the Economy, in May 2019; and, most recently (v) a public consultation document entitled *Secretariat Proposal for a "Unified Approach" under Pillar One* on 9 October 2019 (the Consultation Document). The OECD also held a public consultation in Paris in March 2019.

The Consultation Document invites interested parties to provide comments on the Secretariat's "Unified Approach" no later than noon Paris time on 12 November 2019. I am pleased to respond to the OECD's request for comments on behalf of Tax Executives Institute, Inc. (TEI).

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 57 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting sound tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent over 2,800 of the leading companies in the world.[4]

TEI Comments

TEI supports efficient, predictable, and stable tax regimes because they promote long term investment, growth, and result in fewer disputes between taxpayers and tax authorities. We approve of the Consultation Document's approach to develop a balanced proposal under Pillar One, which generally attempts to address the relevant challenges in an efficient and predictable way. That said, the Consultation Document suffers from a number of flaws, including (i) the potential for multiple taxation and ensuing disputes: (ii) introducing excessive compliance costs from a cost/benefit perspective; (iii) general incompatibility with current bilateral tax treaty networks and associated relief from double taxation; and (iv) conflict with the current OECD transfer pricing guidelines. Below we expand on each of these flaws, provide other general comments, and answer the specific questions posed by the Secretariat.

General Comments

The Necessity of Repealing Unilateral Taxes/Measures

The proliferation of unilateral taxes targeted at highly digitalized businesses or certain business models is a major impetus for the OECD moving forward with BEPS Action 1, the resulting "Pillar One" approach, and the unified approach in the Consultation Document. These unilateral measures include diverted profits taxes, a digital advertising or services tax, a withholding tax on services, equalization levies, multinational anti-avoidance laws, and other analogs. The measures impose a heavy tax and compliance burden on businesses and are intentionally targeted at certain industries, sectors, or business models in what TEI views as discriminatory manner. This discriminatory approach is in contrast to the OECD concluding the digital economy cannot be "ring-fenced" in the Final Report. TEI believes any

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[4] TEI is a corporation organized in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

OECD agreement on Pillar One must require these taxes be repealed as a condition of such an agreement. The purpose of the OECD's renewed work in this area would be unclear if these unilateral measures remained in place after an agreement was reached.

The Need for Multilateral Agreement

The unified approach set forth in the Consultation Draft will only lead to a simple and administrable system if countries agree to consensus, binding multilateral approach. Such an agreement would need to address the scope of the proposal, the allocation mechanism, review and audit procedures, and prevention/elimination of double taxation.

A multilateral approach should be captured in a multilateral agreement, similar to the multilateral instrument (MLI) under BEPS Action 15. It is critical for any such instrument to provide for interaction across multiple jurisdictions, rather than merely modifying current bilateral tax treaties. The Consultation Document anticipates reallocating taxing rights from residence to market/source jurisdictions. This will result in an allocation from more than one residence jurisdiction to a single (or multiple) market jurisdictions and a concomitant increase in disputes among those jurisdictions. Thus, any new MLI must address the potential for multijurisdictional disputes.[5]

Separately, the scope restrictions for application of the unified approach under any such agreement or instrument should be clear and easily administrable. Whether and what part of a multinational enterprise (MNE) is subject to the unified approach should be assessed in accordance with a single, global, consensus-based set of rules – not rules determined by local jurisdictions.

Finally, implementation of the new nexus and other rules, and the dispute resolution mechanism, must be deployed simultaneously by all countries. Disputes are guaranteed to arise if one country begins reallocating Amount A before another country even adopts the new approach.

The Need for Multilateral Dispute Resolution and Correlative Adjustments

The unified approach should introduce a truly multilateral dispute resolution mechanism with automatic correlative adjustments to reduce and hopefully eliminate double taxation resulting from the approach. The absence of a multilateral mechanism will lead to endless disputes and double taxation because the unified approach will allocate Amount A from one (or more) jurisdiction(s) to a market jurisdiction (or multiple market jurisdictions). The current dispute resolution mechanisms of bilateral tax treaties are incapable of settling such cross-jurisdictional disputes.

It is essential that any agreement re-allocating part of the non-routine profits of a multinational enterprise to market jurisdictions (i.e., Amount A) include clear rules for determining which entities in a multinational group earn such non-routine profits under existing transfer pricing rules as these are the entities entitled to double tax relief. Non-routine profits of many MNEs reside in different legal entities across multiple jurisdictions. Reallocation of such profits will therefore require a multilateral instrument covering all impacted jurisdictions because an agreed change in one bilateral situation will likely lead to

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[5] See our comments in the next section of this letter below.

multiple changes in other bilateral situations. Using a string of bilateral tax treaties is therefore unlikely to eliminate double taxation in a timely manner, if at all. Furthermore, not all countries allocated an Amount A will have double tax treaties with the countries from which Amount A was allocated and so there will be no bilateral tax treaty dispute mechanism to utilize.

Finally, the Consultation Document suggests the use of binding dispute resolution with respect to Amount C. TEI agrees with this, however, the use of binding dispute resolution should be available to settle disputes with respect to Amounts A and B as well.

Alternatives Withholding Taxes

Some countries may be considering imposing withholding taxes to collect Amount A. A pure withholding tax approach to Amount A would add another layer of administrative requirements and cost for taxpayers if the withholding tax is not considered the "final" tax. That is, if a taxpayer's tax is over or under withheld by a particular jurisdiction based on the imperfect information held by the jurisdiction, the taxpayer would need to engage in a second administrative proceeding (filing for a refund or filing an additional withholding tax return) to correct the erroneous amount withheld by the taxing authority. This may happen every year as it is unlikely that the market jurisdiction has the information necessary to properly determine Amount A.

A better approach would be to administer Amount A as if it were a fully creditable tax, rather than requiring a taxpayer without a physical presence in the jurisdiction to file a net income tax return. The taxpayer would merely pay over Amount A, as determined by the taxpayer's parent jurisdiction, as a "final" amount of tax due, without having to provide the additional (and burdensome) information required by a net income tax return filing in each individual market jurisdiction (unless the taxpayer meets the current standard for filing a net income tax return in the market jurisdiction).

The Need for a Single Audit Jurisdiction

TEI recommends only one country – the parent company country – be permitted to audit Amount A for administrative and compliance simplicity. Subjecting Amount A to audit in every country in which an MNE owes Amount A will lead to endless time-consuming disputes. Thus, TEI recommends market jurisdictions be required to rely on the audit of the parent company. Market countries could review the audit determination via information sharing agreements.

Clarifying the Impact on Other Taxes and Duties

The OECD should address whether the new tax has any correlative impact on indirect taxes and other similar duties. TEI recommends the OECD provide indirect taxes should not be imposed on the sales attributable to Amount A under the new rules. Similarly, the OECD should clarify merely owing Amount A (or B or C) does not create, without more, filing or tax obligations in the local jurisdiction,

whether in respect of VAT, GST, payroll taxes of employees working for a permanent establishment, customs duties, among others tax-related obligations.

Other General Comments

The OECD overestimates MNE access to, and possible use of, data in the Consultation Document when it comes to consumer/user location and otherwise. Additionally, the sales data the OECD believes is available to MNEs under the Consultation Document instead *may* reside with the platform owner rather than with the MNE "seller," in light of the number of jurisdictions introducing "platform" rules to deem the platform owner to be the seller from an indirect tax perspective. The platform owner, however, also does not have access to such information on consumer/user location, in TEI's experience.

The OECD also generally underestimates the costs involved in presenting profit, loss, revenue and profitability numbers along different business segments, sectors, and country or regional lines. It is important to emphasize that determining profit at product level, segment level or country/region based on financial consolidated accounts would be extremely challenging. The way an MNE segments and allocates revenues and costs to different accounting sectors depends on the individual company and its structure. This segmentation can only be done one way at a time: in cases where costs and revenues are segmented for accounting purposes along the lines of certain business segments, they cannot be segmented along different business segments for tax purposes. The OECD should not recommend its own methods of financial statement segmentation for purposes of the unified approach for these same reasons.

Finally, we recommend no additional allocation be required under Amount A if a business is currently compensating a jurisdiction at or above whatever amount the OECD member states and Inclusive Framework agree. That is, market countries should not receive a double benefit if the purpose of the OECD's work in this area is to allocate an additional "modest" amount to market jurisdictions.

Answers to Questions Posed for Public Comment by the Secretariat

Set forth below are TEI's responses to the specific questions the Secretariat posed regarding the policy, technical, and administrative issues raised by 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;*

The Consultation Document states "large consumer facing businesses" are those which "generate revenue from supplying consumer products or providing digital services that have a consumer-facing element."[6] The definition of "large consumer-facing businesses" needs to be further delineated, as

6 Consultation Document at 7.

suggested in the Consultation Document.[7] For example, how to define a consumer facing business and its interaction with customers where the business has limited direct sales and interactions with consumers/end users because its products and services are sold to consumers/end users by unrelated manufacturers, distributors and/or retailers?[8] Paragraph 19 of the Consultation Document states businesses in scope would also include "highly digitalised businesses which interact remotely with users . . . as well as other businesses that market their products to consumers and may use digital technology to develop a consumer base"; where would the line be drawn between businesses that rely heavily on digital technology ("highly digitalised businesses") and those that have a moderate use of digital technology? Such a line will be difficult to draw and, moreover, it seems it will constantly be changing as the use of "digital" technology and different business models evolve. Again, the OECD should not attempt to "ring fence" the digital economy in its work in this area, as it concluded in the Final Report.

TEI recommends consumer facing business be more clearly defined to prevent disputes and should consider whether the business has access to customer specific location information, such as a billing or contact address. A business may not have a billing address for a consumer, for example, if it sells through a distributor even though the business may fall under the definition of "consumer facing."[9] Further, the threshold for applying the new rules should only take into account the consumer facing business and not the entire business of the MNE when only a portion of the business is consumer facing.[10] In other words, companies with a small fraction in percentage or dollar amount of sales in scope (i.e., that are consumer facing) should be excluded from the rules altogether even if the MNE's overall sales are substantial. This may be problematic in certain cases, however, because an MNE may sell items used by both individuals themselves and businesses (e.g., cars, computers). Would the business be required to estimate the split in such sales for the consumer facing determination?

Depending on how the OECD eventually defines a "large consumer-facing business", certain financial information relevant to the definition may not be readily available. Financial statement segmentation/reporting threshold requirements for a group with both a consumer-facing business (as defined by the OECD) and a non-consumer facing business may be different from tax requirements. There may also be regional differences where some countries regard an industry as consumer facing and others do not. Similarly, financial statements by business line may not be readily available and may vary between companies even within the same industry (e.g., GAAP vs IFRS; companies may use different methodology to allocate non-direct/specific costs). Thus, a requirement for multinational enterprises to track whether they include a "large consumer facing business" in addition to their regular financial and tax reporting would be costly and time consuming. Expense allocations between business lines will generate disputes both between taxpayers and tax authorities and between tax authorities themselves.

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7 *Id*.

8 See also our answer to Question 1.c. below.

9 In such a case the "consumer facing" business may only have a billing or contact address if the consumer bothers to register the product with the manufacturer (e.g., for warranty purposes).

10 See also our answer to Question 1.b. below.

MNE accounting systems generally cannot produce accurate information regarding business segmentation differing from the segmentation maintained for financial reporting purposes, as noted above. Moreover, business segmentation data, where available, may contain sensitive, competitive information.

In sum, even a consensus OECD/Inclusive Framework-wide standard for how multinational enterprises track whether they include a "large consumer facing business" in addition to their regular financial and tax reporting would be costly, time consuming, result in substantial uncertainty and endless disputes. TEI again recommends MNEs be permitted to use their financial statement reporting standards for purposes of segmenting an MNE's operations or use aggregate financial statement information.

b. Defining the MNE group;

A particular challenge when defining the MNE group is whether to include only an MNE's sales/income within the scope of the proposal (i.e., attributable only to the large consumer facing business of the MNE) or the entire MNE group (e.g., the same as what is used for country-by-country reporting under BEPS Action 13). Only sales attributable to a consumer facing business should be counted when determining whether an MNE group is "large" in TEI's view. It has been suggested that the country-by-country reporting threshold of €750 million be used for this determination. TEI believes this amount should be higher to reduce the scope of the final agreement. In addition, sales directed at consumers resident in a particular jurisdiction should only be attributable to that jurisdiction. A sale marketed and concluded in jurisdiction A to a resident of jurisdiction A, for example, should not be attributed to jurisdiction B if the good or service is consumed in jurisdiction B.

c. covering different business models (including multi-sided models) and sales to intermediaries;

While some financial accounting standards may require a certain amount of reporting by an MNE's business lines the amount of disclosure required by such standards does not generally raise competitiveness concerns (e.g., by revealing proprietary and/or confidential business information in published financial statements). Thus, if an MNE's "consumer-facing businesses" must be segregated from its other business lines and reported under the proposed OECD rules, it raises competitive concerns about the potential disclosure of proprietary and/or competitively sensitive information. Similar concerns were raised by stakeholders with respect to the country-by-country report under BEPS Action 13, even though tax authorities are required to keep such information confidential. TEI strongly recommends similar confidentiality requirements apply to information relevant to Amounts A, B, and C.

The OECD should also define what is meant by an "intermediary." Is an intermediary simply a third-party distributor with its own business? Or does the OECD view an intermediary as simply a conduit for the large consumer facing business to make its sales? Would an intermediary include a third party that makes changes to the product before selling it to consumers? If not, how much change to the product would be necessary before the intermediary is considered as selling its own product? Would an intermediary include a third-party distributor distributing products and/or services for parties other than the MNE?

Paragraph 23 states

> [t]he intention is that a revenue threshold would not only create nexus for business models involving remote selling to consumers but would also apply to groups that sell in a market through a distributor (whether a related or non-related local entity). This would be important to ensure neutrality between different business models and capture all forms of remote involvement in the economy of a market jurisdiction.

In TEI's view sales to third party distributors (intermediaries) should be considered business-to-business (B2B) sales and not business-to-consumer (B2C) sales, and thus potentially outside the definition of a large consumer facing business. It would be difficult if not impossible to obtain the relevant information regarding third party distributors' sales to the ultimate consumers or users. Moreover, such information is proprietary and thus again raises competitiveness concerns if it must be shared with. Even if B2B sales from a producer to a distributor are considered to have a consumer facing component (because, e.g., the producer advertises its products directly to consumers even if it only sells through third party distributors), it would still be difficult for the producer to obtain precise information on the location of its users or customers without running into the difficulties set forth immediately above.

d. the size of the MNE group, taking account of fairness, administration and compliance cost;

In addition to the issue noted under question 1.b. above, another issue is whether an MNE group satisfying a global sales threshold should also need to satisfy a local sales or users threshold before being required to report in a particular jurisdiction. That is, if an MNE is determined to be a large consumer facing business based on its global sales, must it then also file a return or report sales in a jurisdiction where its sales/users are considered *de minimis* (and should *de minimis* be determined with reference to the size of the MNE or the local jurisdiction)?[11]

More broadly, it is imperative that all participating jurisdictions have consistent tax rules and thresholds for applying the new Pillar One standards (whatever they may be). It is obviously anticipated that MNEs will be required to file tax returns in many new tax jurisdictions as compared to the previous rules, which will substantially increase tax compliance costs. MNEs will incur additional costs driven by the need to devise additional accounting ledgers and systems to track the information required. For these reasons, jurisdictional variations with respect to the size of the global MNE group to which the rules will apply, as well as to any local sales or users thresholds, should be minimized to the extent possible.

e. carve outs that might be formulated (e.g., for commodities)?

The Consultation Document acknowledges extractive industries and commodity sales could be considered out-of-scope; likely because these business models are predominantly neither highly

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[11] Of course, if an MNE is using a third-party distributor and thus cannot obtain information about the location of the distributor's sales or their amount, then applying a *de minimis* threshold to the MNE's sales in a particular jurisdiction would be difficult if not impossible

digitalized nor consumer-facing. Further, the Consultation Document recognizes that the arm's length principle (ALP) is "working as intended"[12] for certain business models and should be retained. TEI agrees with carving out extractive and commodities businesses for the reasons described below.

For extractive industries, extraction of natural resources requires the extensive use of fixed assets and a significant labor force in the source country, and (in general) the raw materials extracted from the source country are useless to consumers without further manufacturing and/or refining. Thus, there is a strong policy driver for taxation in the source country when compared to other industries: the source jurisdiction creates value by providing the right to extract the resource. Further, double taxation will occur if profits are shifted from source jurisdictions to market jurisdictions in this industry because many source jurisdictions tax extractive activities through production sharing contracts unlikely to be amended as a result of OECD initiatives. In addition, the economy of many developing countries hinges on the taxation of extracted natural resources and related activities.

Similar considerations apply to businesses engaged in commodities transactions. Commodities sales are based on internationally set and/or indexed prices via trading on international market platforms which are highly digitalized. While commodities may be sold on these digital platforms, the platforms are not managed by the MNEs selling the commodities. Products are sold based on an indexed priced, determined by quoted market prices for commodities obtained from transparent market exchanges or from price reporting agencies. Commodity driven businesses are price takers in that they do not have the ability to determine the market price of the commodities sold. Commoditized goods are fungible and, in general, specific molecules are not and cannot be traced throughout the value chain. Commodity sales are generally business facing because commodities are further manufactured by the purchaser before ultimate resale to consumers, much like extractive industries. Finally, from a policy perspective, it is difficult to understand how the commodity-seller is "projecting [himself] into the daily lives of the consumer" and "interacting with [his] consumer base" when the commodity-seller does not know the location of the final consumer.[13]

Certain financial services may also satisfy the criteria for being carved out from the final approach. Collective investment vehicles, for example, do not generally "conduct business" but merely allow investors to pool resources and diversify investments and do not seem to be the type of businesses targeted by Pillar One. The OECD should consider whether these and other types of financial services businesses, and indeed service businesses in general, should be excluded from the scope of the final approach under Pillar One.

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[12] Consultation Document at 6.

[13] *Id*. at 7.

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;*

The definition of sales needs to be consistent across jurisdictions and easily auditable (e.g., through the use of consolidated audited financial statements). Such an approach would represent a departure from what local tax authorities are accustomed to auditing, *i.e.*, the local country GAAP (or other required) financial statements. Local tax authorities will need to agree not to require MNEs to reconcile differences between consolidated audited financial statements and local financial statements prepared for tax reporting if an approach using consolidated financial statements is to be feasible. This in turn raises the question of how best to audit for tax purposes consolidated audited financial statements? One approach, perhaps the only one, would be rely on the tax authority in the MNE's parent entity jurisdiction[14] to audit the information (as noted in our General Comments above).

Separately, TEI recommends there be a single sales threshold applying across multiple countries. Individual, country specific sales thresholds present substantial compliance difficulties and costs for MNEs. For example, if a taxpayer operates in 100 countries and there are 100 different sales thresholds, the taxpayer would have to calculate its sales with differing allocations. Further, if the implementation of the Consultation Document is driven by countries, we fear that reporting will be required based on local GAAP, which will create inconsistencies and result in double (or greater) taxation. Such amounts may, moreover, be difficult to determine when sales into a country are made on an export basis and recorded by an entity in a country other than the destination country (i.e., the MNE recording the sales does not have any reporting data kept on the basis of the local GAAP rules in the destination country).

Finally, clarification is needed on whether the sales threshold – country-specific or MNE-wide – applies to the entire MNE's sales or just the portions of the business that meets the digital nexus scope determination, as discussed with respect to questions 1.b. and d. above. As sales fluctuate, MNEs may move above and below this threshold, resulting in a greater compliance burden as companies monitor the thresholds and tax authorities subject companies with sales near the threshold to greater scrutiny.

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

See our answer to 2.a. above for the challenges involved in having differing, country specific sales or materiality thresholds. In general, there needs be a balanced, simple, and administrable approach across jurisdictions accounting to ease compliance difficulties. TEI is pleased that the OECD recognizes this, noting "an 'administrable' solution is essential, especially for emerging and developing countries."[15] TEI recommends that sales/materiality thresholds be set at a high enough level to avoid disproportionate increases in compliance costs when compared to the amount of tax collected. This may mean smaller

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[14] The "parent entity jurisdiction" needs to be defined. For example, would it be determined on a legal entity basis, a "managed and controlled" standard, or some other metric?

[15] Consultation Document at 6.

and/or developing countries missing out on some of the benefits they may otherwise have received without setting a materiality threshold.

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;*

One appropriate metric would be operating income/loss before (i) foreign exchange; (ii) extraordinary income/expense items (such as gain/loss on divestitures); (iii) goodwill impairment; and (iv) other similar material non-operating items. Operating margin in published/audited consolidated financial statements could be a starting (or end) point for this metric.

    b. *what, if any, standardised adjustments would need to be made to adjust for different accounting standards;*

No adjustments should be made for different accounting standards given the numerous jurisdictions in which an MNE may have a new nexus under the unified approach.[16] A set of carry forward/back rules applying to losses (i.e., when excess profit over routine profit is negative) would need to apply. TEI recommends the OECD explicitly permit a carryforward/back of Amount A if it is negative and suggest rules for how far forward and back the amount could be carried. Alternatively, Amount A could be calculated on a multi-year basis to ameliorate the impact of the year over year ups and downs of business profitability.

    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?*

Taxpayers should be allowed to use audited financial statements on either an aggregate or segmented basis if an MNE obtains them (at the taxpayer's election). Other MNEs should be given flexibility to determine if and how they want to segment their profits across operations, using any reasonable consistent segmentation or allocation method, taking into account the information available to avoid unreasonable efforts and costs. Reporting requirements different from consolidated financial statements by business line/segment, if mandated by tax authorities, may not be readily available and may vary between companies even in the same industry (e.g., companies may use different methodology to allocate non-direct/specific costs; companies in the same industry may have operations in different industry business lines). Such requirements will also generate significant numbers of disputes between tax authorities and taxpayers.

Additional tax reporting requirements by business line/segment would impose a high compliance burden on taxpayers (and an additional administrative burden on tax authorities), especially where a taxpayer's consolidated financial statements do not require reporting on this basis. A key

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[16] Also see our answer to question 2.a., above.

consideration here is how to allocate expenses across business segments/lines. Particularly, countries should not be permitted to devise their own expense allocation rules or methods for business line segmentation under the unified approach. The OECD should also not create its own accounting standard or business line segmentation approach differing from MNEs' audited financial statements for determining Amount A as this would lead to the same problems as individual countries doing so.

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?*

Included in the residual profits/losses of MNEs are residual profits/losses relating to assets other than marketing intangibles. Residual profits attributable to such assets, including intangibles other than marketing intangibles, should not be allocated to market jurisdictions as part of Amount A. The OECD recognizes this in paragraphs 57-59 of the Consultation Document stating, "it is then necessary to determine the split of those deemed nonroutine profits between the portion that is attributable to the market jurisdiction and the portion that is attributable to other factors such as trade intangibles, capital and risk, etc." This division between marketing intangibles and other assets generating residual profits should remain explicit in the final OECD guidance.

Separately, the calculation of deemed routine profit and of deemed non-routine profit allocable to market jurisdictions has the potential to create many controversies. The Consultation Document (understandably) does not go into detail on how deemed routine and non-routine profits are calculated. Different countries may thus have different views and methods, which may create double/multiple taxation and concomitant disputes with taxpayers. Using sales-based allocation keys to allocate the deemed residual profit seems a reasonable approach as sales numbers are generally available, but we note any formulaic approach must be anchored in empirical data. That said, controversies may arise when sales are recorded in a country different than the destination/market jurisdiction when the destination/market jurisdiction audits the sales numbers (if they are permitted to do so instead of being required to rely on the audit conducted in the parent company's jurisdiction, as we recommend above).

The OECD tentatively explains how the non-routine profits are to be apportioned to market jurisdictions. The Consultation Document does not, however, discuss how to allocate and apportion the offsetting reduction in non-routine profits from non-market jurisdictions. The Consultation Document also does not give a full explanation of how routine profits are to be allocated by applying the arm's length system after non-routine profits are removed. It appears such an allocation would be possible only under the residual profit split method. However, in cases under the old method where a third-party comparable uncontrolled price (CUP) could be found, such CUP would no longer be comparable under the approach of the Consultation Document when part of the profit to be allocated under the CUP has been carved out, i.e., Amount A has been removed from the company's profits and allocated to the market jurisdiction. Even if part or all such transactions of an MNE or business unit are carved out from global apportionment, allocations of sales, general and administrative expenses, as well as profits arising out of such a carve out will result in ambiguities and disputes.

Finally, any amounts attributable to carved-out activities (i.e., attributable to the extractive industry or commodities transactions) should be removed for purposes of calculating an MNE's sales threshold (whether it is the €750 million currently used for country-by-country reporting under BEPS Action 13 or some other amount).

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;*

There may be more than one entity receiving non-routine/routine returns because functions are shared by multiple entities within an MNE group. Thus, three or more countries may be enmeshed in the determination and allocation of Amount A, which (as the question notes) is generally not addressed by existing domestic law and bilateral treaty provisions relieving double taxation. This raises the question of whether a completely new dispute resolution mechanism is required or if the current process(es) can be modified? TEI's preference is to have a single multilateral and binding dispute resolution process apply at the parent company level, which implies a new dispute resolution approach.

Separately, there will also be a need to modify multiple treaties across multiple jurisdictions beyond the dispute resolution mechanism. For example, the residency definition needs to be modified so a taxpayer can benefit from a particular treaty. One way to address this would be through a second phase of the MLI.

    b. *building on existing mechanisms of double tax relief, such as tax base corrections, tax exemptions or tax credits;*

One challenge here is instead of dealing with bilateral or a few multilateral jurisdictional disputes, MNEs may now be dealing with substantially more jurisdictions and, therefore, potentially double, triple, or quadruple taxation. The existing foreign tax credit mechanisms for providing double-tax relief will be incapable of providing full relief under the proposal in the Consultation Document.

    c. *ensuring that existing mechanisms for eliminating double taxation continue to operate effectively and as intended.*

TEI agrees with the need to avoid double taxation. However, it seems that the proposal in the Consultation Document will inevitably result in multiple taxation and disputes. Paragraph 22 states the "new nexus rule would be introduced through a standalone rule – on top of the permanent establishment rule – to limit any unintended spill-over effect on other existing rules." If the new nexus rule does not leverage existing tax treaty rules (if that is even possible), such as provisions related to place of taxation of business profits, permanent establishment, and dispute resolution mechanisms like MAP and arbitration, and instead leaves interpretation and implementation of the new nexus rule up to individual countries, double taxation (or more) and controversies will result. Market jurisdictions will compete

among themselves for a greater portion of the deemed residual profit, and with other jurisdictions (e.g., where IP is developed/owned and where manufacturing is located) for a fraction of the remaining residual profit, especially with no clear rules governing the attribution of profit under the current Consultation Document.

Perhaps the only way to avoid double/multiple taxation under the current rules would be an automatic and explicit correlative adjustment in the "source" country (or countries) once Amount A is determined. An alternative possibility is to put in place a global competent authority (or court) consisting of members from each relevant tax jurisdiction to address disputes. To ensure that disputes are addressed on a timely basis, the global competent authority (or court) should be required to address the dispute within 24 months and then the dispute would be submitted to mandatory binding arbitration.

Finally, a much wider use of ICAP (see our response to Question 7.b below) would help alleviate some pressure on existing dispute resolution mechanisms and any mechanisms devised in the future.

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;*

A clear definition of what activities qualify, along with examples, for the fixed return is critical, especially for countries with limited transfer pricing experience. Separately, activities qualifying for routine/fixed returns should not be limited to distribution activities. Examples of other such activities include routine manufacturing and shared services. One way to approach this would be to define distribution activities as everything related to marketing, sales, and distribution, and excluding manufacturing, research and development, headquarters services and extraordinary items (this would require definitions for each, or the definitions applicable to consolidated financial statements could be used).

    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).*

Profitability often varies across companies; within a group it also often varies business lines, regions, and countries. Therefore, it is unclear whether using same fixed percentages to determine routine returns would lead to an economically reasonable result. It would also be impossible to reconcile with the transfer pricing and value chain analysis contained in the OECD's transfer pricing guidelines and documentation requirements. In the absence of other approaches, the OECD could set a fixed percentage varying by industry with the option to use some other percentage if the taxpayer (but not the tax authority) can substantiate why the OECD percentage is not appropriate for its business operations. Of course, it will be difficult to get consensus on an industry-by-industry fixed percentage as well as

determining when an MNE falls within an industry or not. These issues are in addition to the more fundamental question of how to define any an “industry” in the first place.

At times the Consultation Document also suggests residual non-routine profits always accrue to the intellectual property owner.[17] On the other hand, paragraph 57 notes that other attributes, such as trade intangibles, capital, and risk, could also attract a portion of residual profits.[18] Moreover, TEI submits there are situations where the profit exceeding routine profit can be attributed to other functions, like manufacturing or selling/marketing, when these functions involve significant contributions to the value chain. TEI therefore recommends the OECD amend the illustration on pages 11 and 12 of the Consultation Document to make clear that non-routine profit does not always accrue solely to a group’s intellectual property owner(s).

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:*

Before turning to dispute prevention/resolution mechanisms, we note that the determination of Amount C, as set forth in paragraphs 64 and 65, seems (unintentionally) designed to create disputes between tax authorities and taxpayers, as well as among tax authorities themselves. That is, despite the use of simplifying conventions and allocation keys to determine Amounts A and B, taxpayers and tax authorities would retain the ability to create exceptions to the general approach of the Consultation Document if supported by the arm’s length principle. Thus, the document, taken as a whole, does not appear to be much different from the current system if it results in taxpayers and tax authorities asserting differing approaches to Amount C using transfer pricing methods and arguments currently available.

A simpler proposal would be to eliminate Amounts B and C from the Secretariat’s unified approach and instead use Amount A and traditional transfer pricing principles, with mandatory binding arbitration to settle disputes of both amounts. This would achieve the goal of allocating an additional “modest” return to market countries without the additional complications – and potential disputes – arising from the determination of Amounts B and C.

a. *(unilateral or multilateral) APAs;*

Most APAs are unilateral or bilateral. Multilateral APAs are much rarer and almost always involve fewer than five jurisdictions. With the new rules impacting many more jurisdictions (e.g., there are more than 130 countries in the OECD’s Inclusive Framework), multilateral APAs can become very complex and difficult to resolve on a timely basis, such that in certain cases the pricing agreement can no longer be considered “advanced” as it is not complete until after the taxable years at issue have passed.

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[17] *See, e.g.*, Consultation Document at 11-12 (illustrating the application of the unified approach in an example).

[18] The existence of Amount C also recognizes other potential sources of non-routine residual profits.

b. ICAP;

The current ICAP program is limited to low risk taxpayers and less than ten countries participate. ICAP will be unable to handle the complexity and volume of the disputes arising from the new rules without a substantial increase in the number of taxpayers and countries participating, as well a significant increase in resources.

c. mandatory binding MAP arbitration?

See our comments under 5.c., above.

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TEI appreciates the opportunity to comment on the Consultation Document regarding the Secretariat's proposed unified approach under Pillar One. TEI's comments were prepared under the aegis of its European Direct Tax Committee, whose co-chairs are Kris Bodson and Giles Parsons. Should you have any questions about our comments, please contact Ms. Bodson at +32 2 746 36 01 or kbodson@its.jnj.com, Mr. Parsons at +44 793 921 5554 or gilesparsons55@gmail.com, or Benjamin R. Shreck of TEI's legal staff at +1 202 464 8353 or bshreck@tei.org.

Respectfully submitted,
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