ICC Comments on OECD public consultation document: Addressing the tax challenges of the digitalisation of the economy

ICC appreciates the opportunity to provide input on the OECD consultation regarding the tax challenges of the digitalisation of the economy. ICC advocates for a consistent global tax system, founded on the premise that stability, certainty and consistency in global tax principles are essential for business and will foster cross-border trade and investment. ICC recognises the efforts by the OECD to enable countries, within the context of the Inclusive Framework, to work collaboratively towards the development of a solution for its final report to the G20 in 2020. ICC fully supports a harmonised approach to ensure that international tax rules remain relevant and applicable in an increasingly digitalised global economy.

GENERAL COMMENTS

The digital economy is not only revolutionising the way businesses operate but also creates new opportunities for global growth and prosperity. If nurtured appropriately, technological advances and digital connectivity can spur innovation in business models, business networking and knowledge transfer while also facilitating access to international markets for businesses large and small, old and new. Digitalisation will enable improved education, skills, health care and social services for all. As digitalisation continues to be an important driver for global economic growth, policies related to taxation of the digitalised economy should seek to promote, and not hinder, economic growth and cross-border trade and investment. Any change of international rules or principles should be done through a comprehensive, coherent and co-ordinated approach between jurisdictions.

Internationally established tax principles

ICC respectfully recommends that the OECD's work in this area should build on internationally established tax principles to help define the contours of a suitable tax framework for the digitalised economy that encourages business activities, job creation and economic growth. Strengthening the application of internationally established tax principles in any proposed solutions would contribute to building a coherent international regulatory framework for world business whilst also providing a foundation to accommodate continued rapid evolution in digitalised business models.

ICC believes that the following principles may be useful to consider as discussions evolve within the Inclusive Framework to address the tax challenges of the digitalisation of the economy, and particularly in the context of the proposals outlined in the current public consultation document:

Profit-based taxation

The corporate income tax liability of a company should be based on the profits that such company generates with its economic activities and not on its revenues. The allocation of company profits between countries should be based on where the company's activities create value.

Neutrality

Taxation should seek to operate neutrally and equitably between different forms of business activities.

In the context of the digitalised economy, neutrality of taxation means that taxation should seek to be neutral and equitable between forms of digital businesses and between more conventional and digital businesses. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

No double taxation and unintentional non-taxation

Tax rules and systems should seek to avoid double taxation and unintentional non-taxation.

(Administrative) efficiency and enforceability

Compliance costs, including enforcement and collection costs, to businesses, and administration costs for governments and businesses should be minimised as much as possible.

Certainty, simplicity (including predictability)
Tax rules should be clear and simple to understand, so that taxpayers know exactly what is being taxed, how much has to be paid and how and when it has to be paid. This means that the law should be clear and unambiguous, the tax authorities' interpretation of it should be readily available to taxpayers, and advance rulings are available. A simple tax system makes it easier for individuals and businesses to understand their obligations and entitlements. As a result, businesses are more likely to make optimal decisions and respond to intended policy choices. In addition, co-operation and constructive collaboration with key stakeholders is essential in developing a predictable tax system based on clear, consistent and transparent international standards of taxation.

Flexibility
Taxation systems should be flexible and dynamic to ensure they keep pace with technological and commercial developments. This means that the structural features of the system should be durable in light of evolving business models, taking into account that future developments will often be difficult to predict.

Information security
Tax administrations must protect information obtained or held, establish standardised procedures[1] to mitigate potential privacy risks and disclose or exchange information with third parties only as permitted by law. Such disclosure or exchange itself should be based on transparent rules and procedures and secure protocols.

Non-discrimination
Tax rules and systems should provide for consistent application of the principle of non-discrimination in administering a neutral tax system and promoting the equal treatment of all taxpayers before the law. Taxpayers should be treated equally, free from any inappropriate influence, and without bias or preference.

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PUBLIC CONSULTATION: PILLAR 1 PROPOSALS:

ICC supports the OECD Base Erosion and Profit Shifting (BEPS) Action 1 Report conclusions that "*Because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes. The digital economy and its business models present however some key features which are potentially relevant from a tax perspective.*" ICC believes that the digital economy cannot be ring-fenced and therefore a "digital only" approach is an inappropriate response to the challenges created by the digitalisation of the economy. It is ICC's view that attempting to separate a taxing system for "digital" companies could be fraught with challenges that would create uncertainty and negative consequences for economic growth and cross-border trade and investment.

ICC believes that a consensus-based approach to the taxation of the digitalised economy should endeavour, first and foremost, to promote economic growth and cross-border trade and investment. ICC recognises that the proposals presented in the current public consultation document are intended to address the diverse needs or concerns of different jurisdictions and, at the same time, try to address the different circumstances of business in the digitalised context. ICC respectfully submits that the proposals should not violate underlying principles that would, as a result, undermine economic growth and cross-border trade and investment. For example, the proposals based on user-created value may not appropriately reflect the contributions to value of research and development (R&D) and investment in capital assets, as well as the interplay between data and technology. Companies spend billions of dollars annually to create the infrastructure and technology necessary to create the systems that support user participation. Similarly, ICC believes that the proposal with respect to significant economic presence lacks specificity and is not administrable. The significant economic presence proposal, while not adequately fleshed out, would result in an outcome similar to global formulary apportionment. While ICC supports a consensus-based global solution, we believe that global

[1] eg. security frameworks based on international standards, such as ISO, NIST

formulary apportionment would require a level of integration and alignment among countries that is simply not achievable at this time. There would need to be agreement among countries on the details of a global corporate income tax and on an allocation key. Under such an approach, the allocation or apportionment of losses presents significant challenges that need to be addressed. The challenges faced for over a decade by the European Union to reach agreement on the Common Consolidated Corporate Tax Base is indicative of difficulties that may arise on a global scale. ICC acknowledges that the OECD is looking beyond the arm's length principle, however the significant economic presence proposal would eliminate the standard, which would be inconsistent with existing approaches.

ICC notes that the marketing intangible proposal may be best suited to principles already enumerated and developed under the arm's length principle. It would be advantageous in developing consensus that such consensus takes into account the diverse contributions of participants in a digitalised economy, including innovation, production, strategic decisions, financing, investments, risk taking and the contribution of assets and data. Failure to consider all such contributions, that include the DEMPE functions, may be distortive and may undermine countries' broader objectives, e.g. their support for R&D to generate high-value jobs and spill-over effects, which in themselves contribute to economic growth and cross-border trade and investment. ICC further emphasises that any consensus-based approach should focus on underlying principles, including simplicity and certainty, and particularly, dispute resolution mechanisms to eradicate international double taxation of corporate profits.

For ICC, it is also arguable that value is to a large extent created in the country where innovation, production, strategic decisions and financing are made, and related risks are controlled, and that taxation therefore should remain in that jurisdiction. As suggested above, the ICC notes that the consultation document should provide that any rules allocating profits to market jurisdictions should also apply to losses. Countries should not be entitled to the upside risk if they are unwilling to accept the downside risk. Related to this is the clarification that adequate returns to market jurisdiction should preempt additional income allocations under other principles. Country relevance for marketing intangibles can change rapidly and considerably. In case these intangibles are the only allocation driver, the allocation is likely to be volatile.

ICC furthermore underlines the need to strike a balance regarding complexity, administrability and compliance issues versus the objective to change the rules of how to allocate taxation rights among countries. It should be possible to apply international taxation rules in all countries globally and not only in countries with sophisticated tax authorities and experienced private sector participants. Furthermore, it should also be possible for internationally active small and medium enterprises (SMEs) to comply with the rules without encountering excessive costs. Preferably de minimis rules should not only apply to new digital businesses and new nexus definition but equally to existing nexus rules, that have been expanded under BEPS 7 and that should have interaction with the new rules.

PILLAR 2 PROPOSALS:

Preliminary comments

As stated above, ICC supports the work of the OECD and the implementation of the base erosion profit shifting (BEPS) initiative. ICC supports measures to combat tax evasion and aggressive tax planning. Any BEPS measure should however also provide clarity and not lead to international double taxation or undue administrative costs. ICC notes the risk of complexity if single payments should be traced to an ultimate beneficiary and would call for simplicity and clarity in any such endeavour.

The proposals under Pillar 2 imply however that the BEPS project has not been effective so far and further actions need to be taken. ICC believes that more time should be taken to assess the effectiveness of the BEPS recommendations to date before taking further actions. In addition, the proposals under Pillar 2 seem to disregard the base premise for BEPS, which is to ensure taxation where value is created. The minimum taxation actually encourages taxation of profits, irrespective of where the value is created.

ICC would be interested to see empirical data that shows how tax revenues have been affected by the BEPS changes. Countries should now have two years of country-by-country reports and those two years of data may give a sense of the scope of any remaining BEPS problem.

ICC would also be interested to see empirical data that shows how the introduction of minimum tax rules such as proposed under Pillar 2 would materially increase the taxes collected and/or would materially increase the global effective tax rate (ETR) of an affected taxpayer. ICC's members are particularly interested in this regard in empirical evidence to show that other measures are unable to achieve the same (or a better) result than the proposed Pillar 2 recommendations.

If there is indeed agreement that the BEPS project is not effective, ICC would propose assisting the OECD and the Inclusive Framework to further improve the BEPS measures already implemented. In the event that this would be insufficient and additional measures such as the ones proposed under Pillar 2 are indeed considered necessary, ICC would strongly recommend a simplification of the measures to drive design and implementation. As opposed to the proposals under Pillar 2 forming an additional layer of rules, ICC suggests that they should rather be conceived to replace more specific anti-avoidance rules that are currently being promoted to implement other BEPS measures.

ICC recommends the OECD makes it explicit that the Pillar 2 proposals are equal option to the Pillar 1 proposals. In particular, members of the Inclusive Framework should be under no impression that Pillar 1 and Pillar 2 are complementary and must stand together as part of a single initiative, all elements of which must simultaneously be implemented – to the extent that progress is made under either Pillar; it should be made clear that interested countries can move forward with implementation under the Pillar. In any case, ICC supports the OECD and the Inclusive Framework to work towards developing one approach and to certainly avoid introducing multiple options at the same time. Pillar 2 should not be further considered in the event that an option from Pillar 1 could be further developed.

ICC also recommends here as elsewhere that a strong process for arbitration and dispute resolution is built into the mechanics of the final proposal. The Pillar 2 proposals effectively require a multijurisdictional tracking exercise to be conducted (potentially on a payment-by-payment basis). This would not be administrable even if countries agreed on the nature of the transaction. Experience both at competent authority proceedings in the transfer pricing space and on other cross-border disputes often shows that different taxing administrations can view a single transaction differently/can view different counterparties as being involved. Clear and administrable rules need to be implemented in this regard, and the OECD should not shy away from proposing mandatory binding arbitration in order to ensure taxpayers in cross-border transactions have the confidence that they will avoid double or multiple taxation. (Further information on dispute avoidance and dispute resolution mechanisms are included below.) The Pillar 2 proposals could place countries at various points in the economic and tax development scale on the same footing which could result in considerable anomalies with respect to implementation and administration for taxpayers and tax administrators alike.

Specific comments

ICC recommends that the OECD clarifies the comments in paragraph 91 of the consultation paper around substance, and how this is intended to interact with a failure to reach consensus under Pillar 1. For example, in the absence of agreement around the Pillar 1 proposals on nexus and profit attribution, specifically what does the OECD recommend that participating countries reject when applying the Pillar 2 proposals? Paragraph 91 may be read to reject the OECD's recently adopted DEMPE functions. The empirical analysis suggested above could show whether there is evidence of "a substantial amount of intangible and risk-related returns to group entities that pay little or no tax." This data should be analysed before conclusions are reached and far-reaching new rules are adopted.

ICC recommends that the OECD prioritizes a well-founded conclusion in relation to the proposed ongoing thinking (mentioned in paragraph 95 of the consultation paper) on what other kinds of arrangements should be impacted by the Pillar 2 recommendations. ICC firmly believes that certainty and stability are cornerstones of facilitating international trade and does not believe that the introduction of additional focused rules around areas such as thick capitalisation will help in this regard; on the contrary, they are likely to result in ever-increasing layers of complexity for multinationals arranging their cross-border operations. ICC strongly advocates against special rules for particular types of activity within the Pillar 2 recommendations.

Drawing in particular on its members' experiences of US tax reform and the introduction of the so-called 'global low-taxed intangible income (GILTI)' tax, ICC notes with some concern the statement in paragraph 96 of the consultation paper that existing CFC rules would continue alongside the minimum tax rules. It is well-known that GILTI was originally positioned as part of US tax reform to operate as a minimum tax of 13.125%, such that taxpayers with a higher ETR would be outside its scope. However, the complexity of the new rules (in particular the computation requirements of the foreign tax credit pooling calculations) and their interaction with the existing CFC rules in the USA have resulted in a complex regime that does not operate as a pure minimum tax (*i.e.*, taxpayers with ETRs of more than 13.125% are finding in practice that they have residual GILTI liabilities). ICC recommends detailed work be conducted by the OECD into ensuring this does not happen in relation to the Pillar 2 proposals.

ICC is concerned with the statement in the consultation document that the Pillar 2 proposals could be applied on a transaction-by-transaction basis, and/or could incorporate a conduit/imported concept. This is likely to be extremely difficult for taxpayers to comply with (and for tax administrations to monitor compliance with), and ICC is interested to know whether the OECD has empirical information to confirm that the compliance burden would be outweighed to a material extent by the increased additional tax collection facilitated by such a rule.

ICC also notes that the conduit/imported concepts have been borrowed from the BEPS Action 2 hybrid rules, which in principle were designed to stop the use of hybrid instruments/entities, and so are not appropriate to use in the context of (for example) cross-border royalty flows.

In the event that the Pillar 2 recommendations are adopted, ICC members would welcome confirmation that the OECD will recommend the abolition of withholding taxes at source to payments that are not affected by Pillar 2 implementation.

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<u>Dispute Avoidance and Dispute Resolution Mechanisms</u>

The document mentions the need for dispute resolution mechanisms. ICC fully endorses the need for such mechanisms but would also point out the need for dispute prevention by having clear and administrable rules. ICC calls for the inclusion of binding mandatory arbitration into any new framework of allocating taxes among countries. Disputes are mainly between governments/revenue authorities and should be addressed from the outset in any agreement. Taxpayers should not be caught in the middle of intergovernmental disputes.

ICC is an established arbitral institution through its International Court of Arbitration and provides other dispute resolution mechanisms through its International Centre for Alternative Dispute Resolution. In view of the OECD's on-going work in the Task Force on the Digital Economy, ICC would like to reiterate the importance of dispute avoidance and dispute resolution mechanisms (DADRM).

As fundamental changes to the international tax framework are being considered, ICC stresses the importance of continuing to improve DADRM procedures (BEPS Action 14 as the current framework is inadequate). New concepts of taxing companies and allocating profits to countries may be subject to different interpretations and the business community will most likely risk being confronted with increasing instances of double taxation. The risk of double taxation in such circumstances would discourage cross-border trade and investment – which would be harmful for both countries and for businesses of all sizes. It is therefore imperative that robust dispute resolution procedures are in place to reduce double taxation disputes.

As the OECD seeks to garner support and agreement from 128 countries for changes to the international tax framework in the context of addressing the tax challenges arising from digitalisation, ICC believes that the inclusion of mandatory binding arbitration would help significantly in mitigating new risks of double taxation and provide for much needed legal certainty and predictability for companies.

DADRM may also have to be augmented especially in the context of Pillar 2 proposals to provide for bilateral or multilateral advance rulings on transactions. Such mechanisms could well be time consuming but would certainly aid the process of addressing ease of doing business, besides ushering certainty in the medium to long term.

ICC recommends that the OECD includes effective DADRM in the context of its work in the Task Force on the Digital Economy and the Inclusive Framework.

Conclusion

The digitalisation of the economy brings new opportunities as well as challenges. ICC underlines the need for countries to collectively discuss and address the tax challenges arising from digitalisation, through mutual consensus, and reiterates that any solutions should be long-term and have broad adoption by countries to allow for seamless application for business. ICC reiterates that any solutions should embed measures against double taxation for compliant taxpayers, failing which the consequences could hinder global trade in the digital era. ICC remains committed to providing knowledge and expertise on behalf of business with a view towards determining a long-term global solution to address taxation of the digitalised economy.

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The International Chamber of Commerce (ICC)
Commission on Taxation

The International Chamber of Commerce (ICC) is the world's largest business organisation with a network of over 45 million countries in more than 100 countries. We work to promote international trade, responsible business conduct and a global approach to regulation through a unique mix of advocacy and standard setting activities—together with market-leading dispute resolution services. Our members include many of the world's largest companies, SMEs, business associations and local chambers of commerce.

ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.

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