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EBIT comments on the OECD Public Consultation Document Addressing Tax Challenges of the Digitalisation of the Economy

To: Tax Policy and Statistics Division, Centre for Tax Policy and Administration, OECD/CTPA

Sent via upload: TFDE@oecd.org

Brussels, 6 March 2019

Dear David,

EBIT's Members[1] thank the OECD for the opportunity to provide comments on the OECD's Public Consultation Document on Addressing the Tax Challenges of the Digitalization of the Economy by the Inclusive Framework (IF) and in the context of the OECD/G20's Base Erosion and Profit Shifting Project 2.0. Below are a number of issues and open questions that EBIT believes are pertinent to the CFA and the IF's Task Force on the Digital Economy (TFDE) to take into account and do further work on.

EBIT has previously responded to the OECD's work in this area, submitting a response to the OECD Discussion Draft on BEPS Action 1: "Address the Tax Challenges of the Digital Economy" in March 2014. EBIT's views have not fundamentally changed since then[2].

General comments

We welcome the initiative by the OECD to consult on the IF's high-level proposals that reflect the latest developments on a number of policy issues and technical aspects. EBIT encourages the OECD and the IF in their efforts at reaching a global consensus in 2020. Considering the importance of the topic, the effect that the result may have on the global economy, and the ever-increasing number of unilateral initiatives around the world on digital and other taxation measures that have been proposed by tax authorities, we understand the urgency with which the OECD wants to move forward. At the same time, however, we strongly believe that the debate should be held fully, in a steady forward mode and constructive way showing progress with business and other stakeholders concerned.

What business needs in the coming 12 months is to see a sensible, workable and pragmatic internationally agreed approach, which provides certainty and renewed trust in the international tax system for the long term, and which is subsequently implemented in a consistent manner in all 127 IF member countries, and potentially more widely.

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[1] EBIT Members include Airbus Group, BP, Caterpillar, C-Brands, Deutsche Lufthansa, Diageo, GSK, Informa Group, International Paper, Johnson & Johnson, JTI, PepsiCo, Pfizer, P&G, RELX, Schroders, SHV Group, Tupperware and UTC. For more information on EBIT see: www.ebit-businesstax.com

[2] EBIT's written submissions to the European Commission on the draft EU Directives on significant digital presence and a digital services tax (May 2018), on the EC's public consultation on fair taxation of the digital economy (December 2017), and EBIT's Key Messages on the Taxation of the Digital Economy (December 2017), see: http://www.ebit-businesstax.com/#papers

EBIT Members ask the OECD and the IF to deliver a global consensus approach by 2020 as planned, against the following principles:

- Simplicity
- Single taxation
- Neutrality / no ring-fencing
- Tax deductions for all business expenses
- Consideration of broader tax implications
- Clear objective guidance where possible
- Appropriate balance between unilateral and multilateral approaches
- Realistic new approaches to multilateral advanced pricing mechanisms
- Based on the existing Arm's Length Principle, at most minor deviations
- Effective, fast and binding dispute resolution
- Substantive stakeholder consultation with business.

In light of the fundamental importance of this project, EBIT Members have noted with some concern the limited timeline afforded by the OECD of 15 working days for stakeholders to respond to this public consultation at this stage of the policy-making process. We wish to underline to the OECD the importance of regular and deep consultations with business groupings. EBIT always stands ready to provide input.

Reform should be based on international consensus and agreement. Beyond the User Participation Proposal, it is not clear to EBIT Members that the OECD and IF members have agreed on the problem they are trying to solve. There is an apparent disconnect between the stated issues and some of the proposed solutions[3]. For example, the OECD must clarify whether the objective of the project is to address taxing rights more generally or to address specific issues that are perceived to relate to certain types of digital businesses. The former implies a wide-ranging solution that will cause uncertainty and disruption for multinational groups across all sectors and tax authorities alike. The latter implies a more targeted solution, which implies ring-fencing (contrary to the conclusions of Action 1), would be difficult to target accurately and would struggle to keep pace with the rate of change in business models. Alternatively, is the project aimed at simply trying to ensure minimum taxation globally on all revenues? The answer to this question determines the approach to be taken between now and 2020.

The need for much improved, rapid and binding dispute resolution processes cannot be underestimated. We believe it is necessary to reconsider the mechanisms to avoid double taxation to remove the risk of a potential disruption of international trade. This is an opportunity for the OECD and IF, together with the G20, to introduce a minimum standard introducing enhanced dispute resolution mechanisms before the adoption of any new profit attribution rules. Unilateral measures will increase the risk of double taxation. Binding arbitration rules in the event of disagreement between tax authorities should be a requirement of any new regime.

The proposed rules are potentially broad in scope and without carefully developed definitions will potentially affect businesses whose business models do not benefit significantly from the issues that this proposal seeks to challenge and, indeed, potentially adversely impact them. Digitalization is changing the way all businesses operate. As the digital economy is increasingly becoming the economy itself, all businesses are heading in a similar direction. It would therefore be inappropriate, to ring-fence certain business models. At the same time, it would be equally inappropriate, however, for the changes to apply indiscriminately to business models where no specific issue or concern in connection with taxation has been

[3] Part 2.1 states that the issue arises where businesses use digitalisation to interact with a jurisdiction without a physical presence, whereas the marketing intangible proposal has no nexus to a digital presence and its application is far broader.

raised under the existing international tax framework. It is of concern that some of the legitimate and real-life business models called out in the proposal are considered or framed as being part of a contrived structure. Limited risk distributors (LRDs) for example have a real physical presence and targeting LRDs inappropriately therefore would not solve the issue of how digitalization is facilitating a business interacting with a market without a physical presence. It would seem logical that all the merits of a business model need analysing with the aim of avoiding unwanted spill over effects to those models that should remain out of scope. Such can in EBIT's view only be achieved through a thorough analysis as advocated under the Arm's Length Principle.

The consequences for national economies also need to be thoroughly assessed and evaluated by the OECD and the IF. Countries with large exports, and, in particular if a substantial part of the value is derived from R&D intensive goods and services, would lose considerable tax revenues if the residual profit was allocated, in full or partly, to market countries. The costs for innovation and development would likely remain in the exporting country while future profits would, at least partly, be taxed in other countries, without proper recognition of the costs or previous losses. To be consistent with the output of the other BEPS Actions around DEMPE functions, value is to a large extent created in the country where innovation, production, strategic decisions and financing are made and that taxation therefore should remain in that jurisdiction.

EBIT considers that the proposals appear to be a departure from the Arm's Length Principle/standard and seem inspired by unilateral measures that several countries have introduced (or are in the process of introducing) including rules allocating to that country the right to tax certain alleged income. EBIT believes that a departure of the existing Arm's Length Principle, which was recently reinforced under the BEPS Project, should be avoided. However, should modifications to the Arm's Length Principle be considered, EBIT calls on the IF and OECD to provide early, clear and detailed objective guidance where possible if it is indeed the intention to modify the Arm's Length Principle, because such a substantial move would inherently add to increased complexity and uncertainty, not only for business and other taxpayers, but also for tax administrations, tax courts, arbitration committees and other relevant parties. For example, where there is an intention to adopt a residual profit split outside the Arm's Length Principle care should be taken in the determination of non-routine profits and the interaction with existing rules. This should only apply where one of the risk patterns identified above applies.

Regarding the minimum tax/anti-base erosion rules, any solution reached must be designed in a clear and unambiguous way assorted with pragmatic and balanced reporting or documentation standards, and must include coordination rules between jurisdictions, local country tax regimes, and other proposals to ensure proper allocation and maintenance of taxing rights. Special rules are essential for investment funds that benefit from low tax/zero tax regimes as a matter of public policy. This is particularly important for payments of dividends, interest and capital gains.

The income inclusion rule should not apply to low-tax profits that relate to the domestic business of companies in low tax jurisdictions. For instance, if a country chooses to tax domestic business at a low rate there should be no top up for foreign owned businesses (otherwise, this grants a competitive advantage to domestically owned businesses and would interfere with countries' sovereignty).

For base eroding payments, the deduction should be linked to the degree of 'under taxation' rather than a blunt cut-off situation. For example, a zero tax rate should not lead to a greater disallowance than a 5 % rate.

Potential carve-outs that might be contemplated and afforded to businesses that fall into particular categories need to be carefully considered. Any exemptions or exclusions should be globally recognized rather than countries making unilateral decisions, which would almost certainly result in inconsistent application of the rules, double taxation and disputes. This review should include the policy objectives of the system, the extent to which businesses can plan their affairs, the proportionality of the measures and other factors. For example, the OECD's Interim Report (paragraph 443, page 186) referred to looking at activities in the financial services sector bearing in mind the level of regulation and the features of businesses or particular activities. The incorporation of any thresholds, based on size or levels of activity / revenues in a particular country, so as to apply measures to large multinationals as opposed to SMEs, for example, need to take into account the cliff-edge effect of the threshold (and businesses which may dip in/out of the new regime) and could have implications for broader economic issues such as encouraging global growth.

Specific comments

User Participation Proposal

Scope:

The User Participation Proposal clearly ring-fences the digitalized economy. As EBIT has submitted to the OECD and the EU Commission on a number of occasions,[4] in line with the BEPS Action 1 conclusions, we strongly believe that ring-fencing the digital economy and applying tax rules on that basis is neither appropriate nor feasible given the different levels of digitalization of businesses. It is therefore key for business that the neutrality principle is satisfied for any of the IF/OECD solutions proposed.

We consider that there is nothing *conceptually* different about the role of 'active users' in the digitalized business compared to various parts of the 'traditional' economy, e.g. a credit card company relies on active users in a multi-sided model (involving the merchant and the consumer) and benefits from network effects (credit card companies for instance make more money from more transactions if more merchants decide to accept their credit cards).

We also do not think that it is *practically* possible to ring-fence in the way that is proposed here and for instance by the United Kingdom. For example, the definition of 'social media' in the UK Government's Digital Services Tax Consultation[5], would take into scope every company that has a space on their website for consumer comments and advice, even when this is used as a marketing tool, rather than directly monetized.

Section 2.2. in particular sets out the three characteristics that cause challenges that need to be addressed: *scale without mass*, a *heavy reliance on intangible assets*, and the role of *data and user participation* that enable highly digitalised businesses to create value by activities closely linked with a jurisdiction without needing to establish a physical presence. The User Participation Proposal focuses on 'certain highly digitalised businesses' (paragraph 18 of the Consultation Document). This is a far too generic description to be practically applicable in EBIT's view. If this proposal were to be adopted, it would be important for the OECD and the IF to develop a clear definition of the term "highly digitalised businesses".

We believe it is a fundamentally flawed approach to try to ring-fence business models now when in a few years there will be new/different business models that we can't even conceive of today. All businesses are becoming increasingly digital, albeit at different timeframes. As this is meant to be a 'long term' measure, EBIT respectfully requests the OECD and the IF to

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[4] EBIT comments to the OECD April 2014: http://www.ebit-businesstax.com/pdf/pwc-ebit-comments-on-the-oecd-discussion-april-2014.pdf

[5] HM Treasury Consultation on DST: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754975/Digital_Services_Tax_-_Consultation_Document_FINAL_PDF.pdf

factor in this natural consequence of the advancing digitalisation. Unless the scope is much more clearly defined, it could lead to groups being caught under the approaches that are not clearly defined by any of the characteristics outlined in that paragraph, leading to a much broader application than originally intended.

Method:

The profit-split methodology proposed may not be the most appropriate method to tackle the issues around digitalised business.

There is too much uncertainty about *how* profits would be allocated under this method.

- Firstly, is residual profit to be calculated for the business as a whole or just the in-scope aspects of the business model? If the latter, how is that allocation between in- and out-of-scope activities to be done, in particular for integrated businesses (as almost all are integrated to some or other extent)? How are the profits that have already been determined according to the Arm's Length Principle to be reduced for this adjustment: This should not likely pose a major issue if a residual profit split is already used or in place (but most businesses do not or most transactions or operations are not dealt with under a profit split method, certainly not at group or enterprise level). If you have already priced each transaction according to the Arm's Length Principle standard/comparables, how would adjustments be made to remove the component of profit that would become attributable to user participation?

- The next step is to determine the proportion of the residual profit (or loss) that relates to 'user participation', but how is that to be done? We are not aware of any academic research or existing economic methodologies that have ever done or attempted this. Is it to be a fixed percentage for all businesses (ignoring that the relevancy of users may be very different in different businesses) or will it vary by business type (almost impossible to categorize) or by individual business (but then what is the methodology? – this will be highly judgmental and arbitrary, bound to be open to huge cross-border disputes)

- A further step requires allocation of profits to countries where users are located but:

    - Is this <u>all</u> users or only 'active' users (however defined)? What about entirely passive users (e.g. people using Twitter as a newsfeed who never tweet, or Facebook members who are actually dead)? What about users that aren't human e.g. machines talking to machines (e.g. smart vehicles and the internet of things)? Is a corporation a user?

    - How will users be tracked reliably? Many businesses do not track user location, as it is not relevant to their business models. It is not *possible* to track users accurately: it is estimated that more than 25% of all users mask their IP address via Virtual Private Networks. For VAT purposes it is possible to identify a location because businesses collect billing addresses, credit card details etc. for their customers. That is not the case, however, for users. It is also regarded increasingly as unethical to collect such data about users and it may not be possible to do so without obtaining the explicit consent of users under the EU's GDPR regulations.

The User Participation Proposal also alludes to using revenues from users for the allocation or profits (loss), but how does that work when there are no (direct) revenues from users? Again, it seems to require some highly judgmental and arbitrary allocation rules.

The compliance burden from this proposal would be huge, requiring massive investment in systems to track and collect data that is not currently available (and even then, it would be incomplete and imperfect). It would also require businesses to establish tax registrations in multiple new jurisdictions. There would be huge scope for disputes with multiple tax authorities. For those reasons, the only conceivable practical way to do this would be to follow the “one-stop-shop” approach and have businesses file and agree everything (including the allocation country by country) with their home tax jurisdiction and leave it to the tax authorities to reallocate revenues without any further filing requirement.

Marketing intangibles Proposal

Scope:

The Marketing Intangibles Proposal at first sight may give the impression to be more equitable than the User Participation Proposal as there seems to be less arbitrary ring-fencing. However, this does mean that the proposal may have a wider impact than perhaps intended. As a result, this approach may potentially adversely impact particular sectors of the economy. For example, the detailed analysis of the DEMPE functions in the OECD Transfer Pricing Guidelines should remain to be recognized for marketing intangibles and the approaches should therefore not arbitrarily influence or reallocate return, for example economic rents, linked to those intangibles.

It is vital that the scope of what is included under this proposal and in particular, what is defined as *“to participate actively* in remote user or customer markets in a way, or to a degree, that was not possible before the rapid technological advances that have taken place in recent decades” (paragraph 68 of the Consultation Document) is clarified. We have some concerns that unless there is a clear definition on what is included / excluded under the approach, it could lead to some unwanted situations. The proposals have the potential to apply far wider than this, including situations where digitalization has not facilitated remote participation and lead to broad scale adoption of destination based income taxation. We set out some examples to illustrate that the fact patterns below are intended to demonstrate the complexity associated with the Marketing Intangibles proposal as described in the Consultation Document:

a) <u>Supplying international customers locally</u> -
A multinational group sells branded widgets to customers in a number of countries. The group sources the widgets locally from third parties suppliers which are branded by the multinational group before being sold to third party customers in the various countries. Profits are recognized and taxed in the local third party markets, with the exception of returns paid to the multinational group’s head office for routine support services plus a compensation for use of the group’s brand/IP.

In relation to the local market, the multinational group would clearly be making use of its trademarked brand, customer lists, customer relationships, and proprietary market and customer data. Accordingly, the multinational group would appear to have a local marketing intangible in the Consultation Document.

The reward for any local marketing intangible would logically have to come from the returns paid to the centre that usually are linked to trade intangibles and other than local trade intangibles. Any allocation of profit to a local marketing intangible would thus reduce this return to the head office jurisdiction. Currently this income compensates the expenditure the head office incurs on R&D (trade intangible) and promotion of the brand (other than local marketing intangible). It would also have the economic effect of overriding the Arm’s Length return (for example based on third party benchmarking, i.e. comparable uncontrolled prices). However, as mentioned in the principles that were highlighted at the beginning of this submission, EBIT believes that any future solution should be based on the Arm’s Length Principle with at most minor modifications where this is strictly necessary. Further, assume the return was paid in the form of a royalty, the suggested approaches would reduce any withholding tax payable on that royalty as a secondary effect.

Is it the intention of the proposal to allocate income away from jurisdictions that invest in R&D[6], to override CUPs or just give the local territory taxing rights, and to reduce withholding tax payable in the local market? In the example above, depending on profitability it would seem that the tax take locally could reduce rather than increase. More generally, there needs to be a quid pro quo around removing withholding tax and ensuring full deductibility for business expenses, both of which already result in double/over-taxation.

b) <u>Sales made through third party distributors</u> – A group active in supply has a valuable consumer goods brand. The supplier entity in Country A sells to a third party distributor in Country B. The distributor sells the goods to customers in Country B and also to unrelated customers in Country C. Who has a local market intangible in Country C? The Country B distributor, the supplier group (which invests centrally in the brand and technology), or both? EBIT believes that where third party distributors are used, the economic terms and conditions of their arrangements should be respected for tax purposes, subject to some anti-abuse measures.

c) <u>Sale of commodities</u> – There are situations in which commodities can be supplied for which there is a customer list and hence, in theory, a marketing intangible exists as defined by the OECD in this area. However, it is questionable that there is any significant value attached to this intangible (which can be labelled a routine intangible), especially if the customers are well-known utility companies or national energy companies. If countries order a delivery of a commodity in which the supplier has no physical presence are the proposals going towards a compulsory tax registration and allocation of taxable profit? We would think this should not because there is no value created but this is not entirely clear.

<u>d) Regulated industries</u> – Certain industries are heavily regulated with engagements with customers/consumers being heavily monitored and controlled. In many countries, product pricing is also controlled. These industries do not engage with customers/consumers in the same way as other industries and an allocation of a marketing intangible to a market jurisdiction in these circumstances would be distortive.

e) <u>Other issues</u> – If it is intended that a group incurring losses would still have to make an allocation in respect of a marketing intangible in a way that the losses elsewhere would increase then that does not appear to be equitable. Similarly, for products with low profit margins the allocation of marketing intangibles could give rise to inequitable results. Loss-making and low-profit margin businesses will require further consideration. In addition, long-term investment (costs) in market intangibles/user intangibles needs to be taken into account. No marketing intangible profits should be taxed if there is no additional profit in the system.

Marketing intangibles should not rule out altogether the option of achieving a similar outcome without abandoning the Arm's Length Principle altogether.

The definition of 'routine marketing function' mentioned in paragraph 44 of the Consultation Document should be clarified to understand whether the OECD and IF anticipate businesses should use the current economic (ALP) analysis to assess what is 'routine' or use an

[6] Our assumption was that the paper looked to distinguish between the treatment of trade and marketing intangibles, so seeking properly to reward those entities investing in trade intangibles but giving taxing rights over market intangibles. It would be critical that the boundary between trade and market intangibles in this regard is clearly set out.

alternative approach instead, and if so, which one, and how will that work? For example, if all 'routine' activities were to be rewarded on a cost-plus basis, would all countries agree to the same mark-up, or would they expect to see different mark-ups for different functions, or by jurisdiction, or something else?

Methods:

The methods outlined by the OECD and IF are unclear and incomplete so it is difficult to assess whether we could be supportive or not. EBIT's Members would therefore first need more information to be able to properly consider the proposals. Still, we believe that there is potential for one-sided approaches that are based on minimum adjustments to the Arm's Length Principle. EBIT will be happy to provide feedback again to such proposals at a later stage in the process.

Significant Economic Presence Proposal

The Significant Economic Presence (SEP) Proposal looks like it could be counterproductive: it would appear to incentivize multinational groups to move away from quite small, low-margin markets altogether, where the tax and administrative burdens from this proposal could outweigh the benefits from being in the market at all.

Formulary apportionment approaches are inherently distortive to M&A activity and insourcing/outsourcing decisions e.g. incentive to outsource manufacturing in high-tax jurisdictions and insource in low-tax jurisdictions etc.

Since the SEP Proposal was introduced at the last moment, there is less detail than on the other proposals but there are some inherent problems with this kind of approach (variants have been considered and dismissed before) and what information there is causes EBIT some additional concerns. Apart from the points raised above and issues already raised in relation to users, were users to be specifically included in determining in-scope revenues:

- beyond the need for a sensible de minimis sales threshold, the inclusion of other factors is unclear and any large business might find themselves in scope with or without any intention to enter a particular market;

- this would appear to change the way in which all corporate profits are allocated between participating jurisdictions though it is unclear which entity will be regarded as having the SEP and how this test would interact with transfer pricing and other rules (or would those have to be changed?);

- to determine the profits tax base, decisions will have to be made about determining sales and the appropriate profit rate to be applied to them - different accounting rules and interpretations may lead to inconsistent application and there are also fundamental market differences that suggest using a global profit rate would, for example, exacerbate the likelihood of an inappropriate profit allocation to many territories;

- there would, more obviously that in relation to other proposals, be double taxation to the extent that countries do not have to follow coordinated rules or do not participate in the SEP approach (there is some precedent in the extent to which different US states compete against each other through interpretations of the forumulary apportionment model used in determining state taxes).

- there is currently no mention of losses in relation to this proposal; and

- using a withholding tax collection mechanism has proved a strong disincentive to business investing in a country (with particular recovery problems and hence double taxation where profits are later assessed).

The discussion in the Consultation Document – like the other proposals – are a break with the expanded discussion developed under BEPS action 8-10 – Aligning Transfer Pricing Outcomes with Value Creation. For example, the proposal does not recognise the extensive discussion and principles on the analysis of risks in the commercial or financial relations between members of a multinational group. Indeed, the control over risk discussion as well as the related profit allocation is completely disregarded under the proposed approaches.

The same is true for the principles with regard to the DEMPE functions of an intangible. According to normal transfer pricing practice, the parties or entities (and by entension the PE) performing the DEMPE functions, using the DEMPE-related assets and assuming the DEMPE-related risks, needs to be identified; which parties control outsourced functions and control specific, economically significant risks?[7] Instead, it would seem that a large part of the DEMPE functions is automatically attributed to a virtual economic presence instead of on the basis of an appropriate analysis.

As discussed in this paper under the User Participation and Marketing Intangibles Proposals, this approach will lead also to a distortion of economic decisions (e.g. through avoiding the thresholds that determine the SEP) and is not a guarantee that BEPS issues will be countered.

Global Anti-base Erosion Proposal

With many of the OECD BEPS measures having entered into force only quite recently and/or still in the process to be implemented fully, the question arises whether a new global anti-base erosion initiative is actually needed at this stage. The impact of some BEPS measures can for instance already be observed, for example, the modified nexus approach of OECD BEPS Action 5, and with regard to BEPS Action 3 Controlled Foreign Company (CFC) rules through the EU's Anti-Tax Avoidance Directive (ATAD) and the U.S. Tax Cuts and Jobs Act (TCJA), and similar measures in other countries like Chile, Colombia and Japan. Nevertheless, EBIT Members appreciate that a number of member countries of the IF consider that the original OECD BEPS Project has fallen short on delivering in particular on arrangements that result in low or no taxation and that additional measures are necessary.

If the OECD and IF do go ahead, this would only seem to be practicable if it works off a common consolidated tax base, which likely would have to be around accounting profits under IFRS/US GAAP. That approach may also drive behaviours: for instance, will tax incentives be changed to become above-the-line credits instead? How would this interact with CFC regimes? Would the IF be able to agree on a common consolidated tax base?

EBIT believe that if initiatives within this domain do garner global agreement, they must address expected design issues and pragmatic reporting concerns. Any solution must include coordination rules between jurisdictions, local country tax regimes, and other Consultation Draft proposals to ensure proper allocation and maintenance of taxing rights. A pragmatic approach would be to contain an ordering rule such that if income is within scope of the income inclusion rule then the base erosion rules are switched off (as already subject to a min tax). In addition, another ordering rule should operate so that only one income inclusion rule applies, and that should be the income inclusion rule of the jurisdiction highest in the ownership chain (i.e. the ultimate parent jurisdiction if it chooses to introduce such a rule). This would seem to align taxation with value creation as excess value could generally be considered to be created by the global headquarters. It would also provide the simplest and most pragmatic approach to coordination rules.

[7] See in particular section B of Chapter VI of the 2017 OECD TPG.

Income Inclusion Rule / Minimum Tax Proposal

There are a number of issues that have not yet been dealt with in the paper, including:

- the rate of minimum tax having an impact on countries and the investment and other behaviours of taxpayers - no rate has currently been proposed though, for example, there may be a significant difference were the rate to be say 10% or something more similar to the US GILTI's 13.125%;
- whether the regime allows for tax to be charged in the residence state at the minimum rate or jurisdictions' domestic rates – the former seems more appropriate;
- safe harbours that reinforce a country's right to determine its own tax rate and fiscal objectives (for example, with appropriate substance rules etc. and lacking other harmful characteristics);
- tailoring the approach to be on a net rather than a gross basis, taking into account appropriate expenses (the US BEAT rules seem likely to lead to severe situations of double taxation because they do not adequately consider these issues);
- operating the rules on a global basis (as GILTI does) rather than on a country-by-country basis;
- operating the rules as a true minimum tax without limiting associated foreign tax credits that can lead to much higher tax rates (as the US rules do); and
- potential challenges from an EU law perspective in relation to the Cadbury Schweppes principle and application of CFC-style rules only to wholly artificial situations.

If the objective is truly to address the base eroding potential of moving, or having moved, IP or other income-earning assets offshore, was this not addressed in BEPS? If it is now feasible to reach consensus on an income inclusion rule, would it not make more sense to make the the minimum standard of choice the principled CFC approach recommended in BEPS Action 3, with carve-outs for substantive 'real' business, with a wide range of countries already having such regimes (including the backing of the anti-tax avoidance directive or ATAD in the EU? This would also likely result in less distortions of location decisions made for economic or business reasons, a stated objective of the Consultation Document.

Tax on base eroding payments

Many of the above points are also applicable in the base eroding payments context, including in an EU context bearing in mind challenges being discussed by the EU Commission with Member States that have similar types of rules (e.g. Germany, Sweden and Austria). If it is assumed that the denial of a deduction would be proportionate to the 'under taxation' rather than in total, it will be necessary to determine how such a calculation should be undertaken. Also, it is not yet clear how under territorial principles it is possible to achieve the subject to tax rule denying treaty benefits in situations where the payment is not sufficiently taxed in the recipient jurisdiction.

EBIT Members trust that the above comments are helpful and are taken into account.

Yours sincerely,

European Business Initiative on Taxation – March 2019

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