Knowledge Solutions

Trade and Investment

Commission on Taxation

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 public consultation on the Secretariat Proposal for a "Unified Approach" under Pillar One, as part of the ongoing work of the OECD/G20 Inclusive Framework on BEPS (the Inclusive Framework) to address the tax challenges of digitalisation. 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 by the end of 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 Secretariat Proposal acknowledges key issues at stake in developing a global, consensus-based solution, including the allocation of taxing rights between jurisdictions; fundamental features of the international tax system, such as the traditional notions of permanent establishment and the applicability of the arm's length principle; the future of multilateral tax co-operation; the prevention of unilateral measures; and the intense political pressure to adapt international taxation to the challenges of the digitalised economy.

ICC reiterates that the OECD's continued 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 solution 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 application of internationally established tax principles, as outlined in the ICC Policy Statement on Taxation Policy for the Digitalised Economy, should underpin the work developed in both Pillar One and Pillar Two, 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. ICC expresses support for the underlying premise in the existing proposals in the Unified Approach that the corporate income tax liability of companies will be based on the profits that such companies generate with their economic activities and not on their revenues.

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Unambiguity of the law, simplicity and clarity on scope of application

ICC welcomes the premise that simplicity and increased tax certainty are common elements that have been identified for all three alternatives under the Programme of Work under Pillar One. While simplicity should not take precedence over established tax principles, it is an important component of a sustainable tax system and especially important for the developing country members of the Inclusive Framework.

In this regard, an important principle is certainty and 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."*

One of the key issues to note is unambiguity of the law which should ensure to the maximum extent, the impossibility for any biased interpretation on any element of taxation. In this context, of significant importance is the definition of a taxpayer, especially with regard to the broad focus on 'consumer-facing businesses'.

To this end, the notion of 'creating meaningful value without a traditional physical presence in the market' and application of the rules not only to customers but also to users (as defined in clause 2.2 (19) of the OECD Proposal) should be carefully discussed. Businesses should have a clear understanding of the new landscape allowing them to distinguish themselves and their operations as taxable or not, in advance, preferably with a reasonable transition period.

ICC supports and encourages the OECD suggestion to discuss and clarify the scope further, particularly with focus on (i) a clear definition and specific criteria which would more clearly determine what is a consumer-facing business, and (ii) a comprehensive list of sectors, goods, services and/or operations which should be carved out (in addition to the extractive industry).

The new rules need to be proportionate in that their impact is in line with the objectives they aim to achieve. The new rules should be clearly defined to address the specified issues and fulfill the objectives as effectively as possible, avoiding undue burden in case there is little adjustment expected and applying only to businesses and business models that inherently reflect these stated issues.

With respect to the arms-length principle (ALP), ICC has identified several points for consideration by the Inclusive Framework members that underline the need for simplicity and clarity:

i. The stated objective of the Unified Approach consultation document is "It is thus essential to design a solution that attracts support from all members of the Inclusive Framework."(19). This strong statement suggests that consensus has been elevated to the highest level, above principle.
ii. While the ALP is presented as a component of the Unified Approach, its role is limited by several factors: 1) the need for simplicity (e.g. simplification in Amount A), the ALP's "incompatibility" with the new nexus rule (Amount A) and 2) to reduce areas of tension in transfer pricing for in-country distribution functions (Amount B). It would seem that simplicity has also been elevated to a principle and indication has been given that it will be a priority for all stages in the profit allocation formulae.
iii. The priorities assigned to political consensus and simplicity suggest the uniform approach formulas and allocation factors will not be based in significant part on the ALP. If not based on the ALP, the formula factors will be "just numbers" and not sustainable.
iv. Attempts to determine tax treatment based on activities may create significant uncertainty and complexity.

Contrary to the Unified Approach's aim for administrative simplification, ICC expresses concern that the current proposals would in effect lead to increased complexity of the international tax system, particularly given that the proposed new rules are expected to apply on top of existing rules. As such, the implications would increase the administrative burden and compliance costs for businesses.

Clarity on scope and scope limitations, formulary approaches and upgraded instruments for elimination of double taxation will not lead to simplicity and certainty if countries do not agree to implement the same rules at the same time and agree to apply a one-stop shop approach to ensure alignment. Such aligned introduction and application will require a multilateral instrument to be introduced and interaction with existing instruments will need to be agreed.

Role of the current (Post-BEPS) arms-length principle (ALP):

Similarly, regarding the ALP, additional principles should be considered which would be adversely implicated:

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

i. The impact on neutrality needs to be the subject of the Inclusive Framework debate.
ii. While the Amount B allocation of routine profit to in-country "baseline" marketing and distribution activities is messaged to be based on the ALP, the need for simplification and to minimise disputes will result in a "fixed" remuneration that may be beyond the ALP.

(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.*

Different rules for in-scope and out-of-scope activities within the same entity create complexity for both taxpayers and tax administrations, increasing costs for both.

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.*

Formula factors and fixed percentages that may be agreed upon now as a proxy for a 'fair' allocation of taxable profits, may not be seen as such in the foreseeable future in view of the continuous fast pace of technological development and associated development of new business models. As such, a taxation system based on formula factors and fixed percentages lacks a certain degree of flexibility unless there is a rule for periodic re-assessment and review.

Impact assessment

ICC notes that the preliminary OECD impact assessment indicates an anticipated increase in global tax revenues, however ICC believes that further clarity regarding the basis of these assertions would be necessary. ICC strongly believes that a thorough economic impact assessment is essential to help inform deliberations and any agreement within the Inclusive Framework in order for countries to have a clearer understanding of the implications of proposed solutions within this context. In this respect ICC respectfully highlights several issues for consideration:

i. The impact assessment continues to fall behind the proposals under consideration
ii. There is limited transparency on the impact assessment work
iii. Deficiencies in the impact assessment creates risk of non-compliance with tax principles considered essential for sustainable tax rules.

The current stage of work on the impact assessment reflects the Unified Approach's scope limitations, effectively targeting digital and intangible-based companies.

i. An expected result of the Secretariat Proposal's scope limitations would be useful.
ii. There is a need to carefully evaluate the economic impact of this non-neutrality as well as debate the policy justification for the expected adverse consequences.
iii. An impact assessment is necessary to estimate tax receipts to enable this evaluation

The Unified Approach should also be developed with consideration of the impact on customs valuation, and how the final recommendation may impact both customs administrations and global traders of tangible products. For example, in a traditional import structure with a product sale to a distributor that becomes subject to the residual profit allocation under the Unified Approach, the mechanism for assessing the tax can impact the price that the distributor pays for the goods. If the residual profit allocation causes a tax on the group principal company (or group IP holder) which is borne by the principal company, the price paid by the importer will continue to be based on the traditional arm's length analysis, and should not change. If, however, the residual profit becomes an obligation of the distributor to the local tax administration, the distributor's profit will necessarily be higher, reducing the price paid for product. If this reduced price is considered a valid transaction value for customs, it would reduce the product customs value from current values. If the reduced price is not considered a valid transaction value, absent coordinated guidance from the OECD and World Customs Organisation (WCO), this will result in a complete divergence of income tax transfer prices and customs values, requiring businesses to have separate approaches for income tax transfer pricing and customs. The WCO and OECD have put significant effort for more than a decade into working to converge transfer pricing and customs valuation rules. Both customs administrations and businesses would benefit from continued coordination of the application of any changes to the current system as the Unified Approach is developed.

Elimination of Double Taxation

No double taxation and unintentional non-taxation – *Tax rules and systems should seek to avoid double taxation and unintentional non-taxation.*

ICC recognises that there are technical and complex questions regarding taxing rights and profit allocation and underlines the need for a global, collaborative effort to address these challenges, through mutual consensus and broad adoption by countries which would allow for seamless application for business. Unilateral disparate tax rules that introduce double or multiple standards create compliance challenges for business, undermine the consistency of the international tax system and global efforts to seek alignment at the international level as well as create the risk of double taxation. Agreed proposals by the OECD Inclusive Framework members should include the repeal of any unilateral measures.

ICC notes that the Unified Approach does not appear to lend sufficient attention to the elimination of double taxation. More specifically the proposed Unified Approach presents three separate approaches for determining the price for an activity, where taxable amounts for Amount A allocation could also be taxable under Amount B or Amount C. The routine return under Amount A is not related to the routine return under Amount B. It is conceivable that the Amount B routine return might exceed the routine amount under Amount A for instance where the Amount A routine return is calculated as a percentage of global profits and Amount B is determined on the basis of costs. As these approaches are not clearly unified, this could essentially create a risk for double taxation. For instance, if a business is already in a country and compensating the country at or above whatever the OECD Inclusive Framework agrees, no additional return should be allocated to the market.

It is essential that the political agreement on how to re-allocate part of the non-routine profits of a multinational enterprise to market jurisdictions (Amount A) includes clear rules for determining which entities in a multinational group earn such non-routine profits under existing transfer pricing rules and should therefore be entitled to double tax relief. Such deemed non-routine profit is currently already taxed in other countries under existing rules. Amount A should not create a new taxing right on the deemed non-routine profit without reducing the taxing right elsewhere. In practice it seems likely that the non-routine profits will be residing in different legal entities in multiple jurisdictions. Reallocation of such profits will therefore require a multilateral instrument that covers all jurisdictions impacted.

ICC has previously noted that any proposals should provide that any rules allocating profits to market jurisdictions should also apply to losses, failing which there would also be a risk for double taxation.

The proposal references the notion of withholding taxes. ICC expresses concern that using the concept of witholding taxes could increase the risk of double taxation. In addition, ICC calls for further detail on crediting withholding taxes which are already levied under the existing international tax system and how that would apply in the Unified Approach.

With respect to the impact assessment, countries would need a clearer understanding of the estimated shifts in tax base, without which countries will be reluctant to commit to surrender their tax base (surrender states) to minimize the risks of double taxation.

Dispute Avoidance and Dispute Resolution Mechanisms

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).

ICC fully endorses the need for dispute resolution mechanisms but also highlights the need for dispute prevention by having clear and administrable rules. ICC would welcome 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.

As fundamental changes to the international tax framework are being considered, ICC stresses the importance of continuing to improve DADRM procedures. 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.

To eliminate double taxation disputes it is essential to put in place robust dispute prevention and resolution mechanisms. In this respect, ICC welcomes the views expressed in the G7 Finance Ministers' Statement which states: "New rules should be administrable and simple… in order to avoid double taxation and ensure the stability of the international tax system, robust and effective tax dispute resolution through mandatory arbitration must be a component of this global solution."

As the OECD seeks to garner support and agreement from 134 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.
It would also be useful to have an indication as to the scope envisaged for DR mechanisms and whether these would apply similarly for Amounts A, B and C outlined in the Unified Approach. ICC recommends that these DR mechanisms should apply to all Amounts.

Conclusion

The digitalisation of the economy brings new opportunities as well as challenges. ICC reiterates that taxation of the digitalised economy should seek to promote, and not hinder, economic growth and cross-border trade and investment, and 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 welcomes the efforts of OECD to find a global solution by the end of 2020 and 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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