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Comments on the Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pillar One published on 9 October 2019

Dear Sir / Madam,

Taxand welcomes the opportunity to provide comments on the Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pillar One published on 9 October 2019. We would like to share our thoughts, based on our experience in advising multinational enterprises. Understanding the challenges to arrive at a consensus position prior to the end of 2020, Taxand applauds the efforts made in this Public Consultation Document and aims to provide constructive commentary in furtherance of the mission.

The following comments have been made considering the principles for the Unified Approach under Pillar One ("**UA**"), which is focused on the allocation of taxing rights. The current work was established in the Programme of Work adopted through the Inclusive Framework and endorsed by the G20 and seeks to identify the commonalities among the three alternatives set out in the Programme of Work under Pillar One, which are:

- To reallocate taxing rights in favor of the user/market jurisdiction;
- To envisage a new nexus rule that would not depend on physical presence;
- Not to be based on the arm's length principle and depart from the separate entity approach;
- To look for simplicity, stabilization and to increase tax certainty.

General comments

The goal of the UA is to designate a solution that is acceptable to all countries and is easy for both taxpayers and tax administrations to administer. The solution to be adopted should, in principle, be simple and practical in order to reduce dispute, promote tax certainty and prevent double or even multilayer taxation.

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As new nexus intends to avoid dependence on physical presence, there are a number of challenges that need to be faced. The most important question regards tax collection. Where taxpayers are not physically present in a country, tax authorities have no lever on such taxpayers to enforce their taxing right. This might inspire countries to apply withholding tax mechanisms (see local DST) where possible or – even worse – other forms of securement payments. Bearing in mind that the work of the OECD originates in preventing taxpayers from being burdened by withholding taxes to preserve cash flow and secure desired investments, such a policy seems contrary to OCED's objectives. Mutual assistance in tax collection matters might offer solutions to this issue. The proposed unified approach must therefore integrate **a ban for withholding tax** to enforce the collection of Amount A, but must hold countries to solely rely on forms of mutual assistance.

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;

b. defining the MNE group;

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

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

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

The concept of "consumers/users" is not clear in the UA. Accordingly, it is uncertain if business-to-business ("BTB") transactions are intended to be within the scope. There is not a clear reason why a BTB transaction should be excluded from the UA scope, considering in the BTB sector there are opportunities to make profits in different jurisdictions without having any physical presence therein.

The definition of a "large consumer facing business" should not be ambiguous and should be easy to identify in order to avoid any incoherent interpretation by different tax authorities and taxpayers. A possible definition of a "large consumer facing business" could be targeted to identify "digital businesses" (not to include technology enabled businesses) and businesses related to consumer-facing products or services.

In this respect a 'highly digital business model' may be understood to mean any type of business which:

- meets the threshold based on the numbers of users; and
- meets the threshold based on the revenue earned from remote business operations.

The threshold in terms of users and revenue can each be prescribed for clear self-determination as to whether the rules apply. The definition should be based on simple predetermined metrics, as any solution that tries to identify the "consumer facing business" looking at the business model would quickly

become outdated as business models are rapidly changing over time. This is particularly true due to the constant evolution of value chains, which makes it difficult to define a border within the value chain itself starting from when the business becomes "consumer facing."

It should also be considered that BTB sectors are not excluded by definition, as BTB may rely on significant marketing intangibles in the market jurisdictions as well. For example, it may be difficult to track the difference when the same products/services are sold to both users in a personal and a business capacity.

An attempt should be made to better define at the OECD level what is a "marketing intangible" in the context of highly digitalized businesses. Taxand suggests to carve out from the proposal those businesses that require intensive presence in the market in which the sales are done ("**market countries**"), for instance: (i) financial and insurance sectors; (ii) extractive industries; (iii) commissionaire activities; (iv) commodities and other BTB sectors and non-consumer products.

To this end, and with an aim towards certainty, Taxand suggests to: (i) define standard metrics by industry (regarding the volume of assets or human resources, for example) to determine those that normally require a certain level of physical presence in the market countries above minimum thresholds; or (ii) determine the specific industries (according to NACE Rev. 2 codes for example) that should be included in the new nexus approach.

If the UA is targeted at digital businesses with consumer facing products or services, there could be a problem as consumers are more mobile and frequently changing their location. There could be a problem for companies in reliably tracking consumers/users that cross borders either on a permanent or temporary basis. A clear definition of consumer/users and its location taking into account users might consume in several countries is necessary in order to reach a solution that is acceptable to all countries and easy to administer both for taxpayers and tax administrations.

Finally, Taxand is aware that some MNEs are worried about the fact that if the UA applied only to certain digital businesses this would require MNEs engaged in varied business operations to prepare segmented financials, which would lead to complexity and uncertainty. In this respect, Taxand does not oppose a solution that focuses on an approach that identifies only the businesses that are out of scope.

For consistency on the definition of MNE Group, a possible solution would be to rely on other existing OECD guidelines where this term is applied. As a viable alternative, in order to initially identify a highly internationalized MNE, a threshold related to a minimum amount or percentage of the annual consolidated revenues that is generated from outside the home country could be set in order to make the UA clear and simple. The concept "abroad" should be defined as any jurisdiction different from the one in which the parent company of the MNE is resident. Moreover, to classify revenues as international, the country of the consumer/user should be considered.
We identify this question as the key question and main weakness of the unified approach from a practical perspective. This question actually demonstrates that value creation that justifies a taxation right only takes place where market-related transactions occur (including B2C and B2B). Value is only created where market related transactions take place. A user base itself does not have any value itself if users do not proceed to buy any products or services. Any definition which includes users rather than relying solely on revenue will create a mismatch between the policy purpose of Amount A and the scope definition.

In order for small and medium enterprises ("SME") to avoid excessive administrative burdens, Taxand suggests that the UA should be limited to large companies (at least initially), until the vast majority of the countries agree to apply it in a consistent manner, anticipating the potential difficulties in application of the UA once implemented. In this regard, the threshold amount for the Country-by-Country Report (MNE with annual consolidated group revenues of at least € 750 million) could also be applied, as we understand this is an amount previously agreed among the OECD members to avoid excessive administrative burdens on SMEs. Once the UA is consistently applied amongst the majority of the countries, as per fairness and equality standards, it must be generally applied to those MNEs complying with the rest of the characteristics indicated.

Despite the above, there are other challenges to be discussed. In particular, it is necessary to consider companies controlled or highly influenced by common shareholders that are not obliged to prepare consolidated accounts (for example, horizontal groups or owned by certain investment funds).
Regarding diversified MNEs, the segmentation of financial statements should also be considered (for example, according to information provided in the annual consolidated accounts as far as there are common rules for its preparation – IFRS). In this respect, the existence of different accounting standards could be an issue. Further, the threshold should be determined only for business segments included in the scope.

However, as a general principle, it is important to note that it appears arbitrary to apply a new set of rules only to MNEs with a certain volume. In principle, TP rules should apply equally, regardless of the size of a MNE. Taxand supports the idea that while initially applied to large MNEs, the UA should eventually apply to all MNEs.
As far as carve out is concerned Taxand suggests:

i) extractive industries such as metals, minerals and ores;

ii) Financial services;

iii) Commodities which derive value from the source of origin, unlike users or market; and

iv) Infrastructure sector.

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; and

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

In principle, the nexus rule suggested earlier by the OECD was based on the threshold related to "users". The purpose with which the unified approach is being formulated may get diluted by shifting the nexus threshold from "users" to "sales"[1].

[1] Moreover it is important to ensure that the new nexus approach does not play any role for other tax (for example VAT/GST) or regulatory purposes.

In this respect, it will be important to ensure the active engagement in the project of the smaller economies/countries with significant R&D potential in order to maintain the improvements on productivity as well as social and economic progress. Furthermore, different sales thresholds by countries or regions have to be adopted to ensure that small economies/countries can also benefit from the new nexus approach. This could be structured, for example, by establishing different minimum sales thresholds per country or region based on the economic capacity of each country or region (measured according to commonly applied macroeconomic indicators such as the GDP or revenue)[2]

In this regard, it will be necessary to solve currency effects and it will also be advisable to establish GDP ranges to be reviewed periodically in order to ensure the simplicity and fairness of the approach.

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;

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

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?*

As the "Amount A" under the new approach will be distributed among countries under a formulaic apportionment, theoretically the best option to serve as the guideline profit metric would be Earnings Before Taxes ("EBT"). Use of the EBT metric reduces the possibility of affecting the effective taxation in a specific country by allocating business related costs, such as financial charges, using an inconsistent approach.

In relying on EBT, we understand it should be feasible to make any necessary adjustments(as all business related revenues and costs would reasonably be included to calculate the EBT) as long as the accounting standards employed for all calculations are comparable.

It would also be necessary to ensure consistency among countries in the applicable accounting standards. However, for the sake of simplicity, Taxand is not opposed to using the home country accounting standards for publicly (and audited) available financials. Indeed, US GAAP and IAS/IFRS accounting principles can be considered as originating from the same conceptual framework. Together they should cover the vast majority of the Inclusive framework countries.

Taxand is aware that the use of EBIT is the one and only metric for measuring the return on invested capital, disregarding the level of financial leverage of the MNE. In fact, all the rest being the same, the use of EBT would imply that Amount A for MNEs with higher financial debts would be lower than Amount A

[2] Countries can be grouped based on tiers as per OECD rankings for GDP, etc., and different threshold for each tier can be set accordingly.

for MNEs with no financial debts, unless the calculation of "deemed routine EBT" is differentiated to reflect not only the business sector and perhaps the geographical location – but also the level of financial leverage.

To the extent that segment reporting (by business or geography) will have to be relied upon, one should consider that segment data is generally presented at the EBITDA level (and only in some cases at EBIT). This is to avoid the need to split depreciation and interest expense among the various segments, which in many cases would involve a level of judgment.

Moreover, the application of specific tax principles adopted in each country has to be carefully ascertained to determine the taxable base. The taxable profit may significantly differ from accounting profit. Accordingly, adjustments are needed especially when the latter are higher than the first.

In this respect, "consolidated profits" may significantly diverge from taxable profits (here intended as the aggregated amount of the taxable profit of each entity within the MNE). In addition to the local tax adjustment requirements, the difference is mainly due to consolidation entries such as, for example, the depreciation or impairment of assets (tangible or intangible) that are recognized as a result of the elimination of investments in subsidiaries. In addition one should also consider that depreciation rates are different depending on the accounting principles/jurisdictions.

Further, it is often the case that provision for risks are recognized in the consolidated accounts only. These provisions would normally be considered not deductible for tax purposes in the local accounts. It could also be necessary to define clear rules regarding the currency effects on the consolidated annual accounts.

As far as question c) is concerned, it could be advisable to determine the consolidated profits segmented by business lines, as far as the group performs some activities included in the scope of the new nexus approach and other activities excluded from this scope.

However, Taxand suggests linking the segmented reporting requirements with the related IFRS provisions. A segmentation that would go beyond what is required by the accounting principles would impact the MNEs that have multiple segments, not all of which may be within scope of the UA. In such a case, in order to arrive at an operating profit relevant to the specific business line an allocation of cost is required which would introduce a further area of complexity and dispute.

Further, in order to apply the Amount A under the new nexus approach in a consistent manner and to avoid effects related to transfer pricing policies, global consolidated profits may be considered instead of other regional segmentations, as these segmentations would not eliminate controlled transactions carried out among consolidated companies resident in different regions and, therefore, the segmented results could be affected by transfer pricing policies.

The same comment would apply to business segments, to the extent that their profits are affected by transfer pricing policies (e.g., management fees and/or royalties from the headquarters). In general, the closer you can get to audited financials, the less disputes are likely to arise over the accuracy of numbers.

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?

Based on Taxand's understanding, in order to determine the Amount A, the starting point is the calculation of the Group profits (see point 3 above).

The second step would then subtract the so called "routine profits" from the Group profits, to determine the "residual profit".

As a preliminary remark, Taxand strongly encourages the OECD to clearly define the concept of "routine functions" and "routine profits". The use of these concepts is widespread in practice, although not well developed in the TPG[3]. In principle, the factors contributing to value creation indicated in the TPG are (i) routine functions, (ii) intangibles and (iii) other factors such as specific market characteristics, location, business strategies, and MNE group synergies.

More specifically, in the context of the example provided in the TPG, the routine profits on manufacturing activity are calculated based on "third party comparable manufacturers without innovative intangible property". No definition is provided with reference to distribution activity. Routine profits should be considered having reference to both manufacturing (intended as the activities required to produce a good or to provide a service) and distribution activities.

In this respect one should also consider that it is extremely difficult to isolate a "routine" return from the return attributable to an intangible or other factor contributing to value creation. For example, when considering the distribution margin which can be observed from comparable third-party distributors, this margin will not only remunerate the "routine" commercial functions, but also the magnitude and quality of the established client relationships, i.e. a marketing intangible. In addition, it should be clearly indicated if the profitability applicable to baseline activities should be determined based on local, regional or global comparables.

The third step would be to allocate the "residual profit" among the intangibles owned and exploited by the MNE Group, taking also into account other factors which may have contributed to value creation. The importance of the intangible and other factors contributing to value creation should be in principle evaluated on a case by case level.

[3] Par. 6.133 "*In matters involving the transfer of intangibles or rights in intangibles* ***it is important not to simply assume that all residual profit, after a limited return to those providing functions, should necessarily be allocated to the owner of intangibles****. The selection of the most appropriate transfer pricing method should be based on a functional analysis that provides a clear understanding of the MNE's global business processes and how the transferred intangibles interact with other functions, assets and risks that comprise the global business. The functional analysis should identify all* ***factors that contribute to value creation****, which* ***may include risks borne, specific market characteristics, location, business strategies, and MNE group synergies among others****.* ***The transfer pricing method selected****, and any adjustments incorporated in that method based on the comparability analysis,* ***should take into account all of the relevant factors materially contributing to the creation of value, not only intangibles and routine functions****"*.
In addition, "routine profits" are mentioned in the example provided in Annex II to Chapter II, Residual Profit Split Method.

In this respect, it would be extremely difficult to pre-define a specific set of rules applicable in all cases. The "residual profit" related to "intangibles" may be, for example, allocated among the countries in which the companies that contribute to the intangible value creation process are resident for tax purposes (it could be measured, for example, considering a cost contribution approach based on the R&D costs and other intangible costs related).

Clear guidance is needed in this respect: if the selection of the allocation keys is left to the MNE, there would be a risk that local jurisdictions will challenge the choice. As an alternative, the residual profits to be allocated between "market users" and "other intangibles", may be split according to percentages to be agreed on between countries (preferably defined by industries).

To facilitate the allocation, we also encourage the OECD to provide a clear definition of the intangibles intended to be remunerated by the Amount A (client list, users' data, etc.). As mentioned earlier, client lists should already be considered when assessing the "routine" return for distribution activity. Once the portion of residual profit attributable to "market jurisdictions" (i.e., Amount A) has been determined, the final step relates to the allocation among the market jurisdictions.

Sales is an audited arm's-length number, but does not take into account marketing spend by jurisdiction. Marketing spend would imply the potential intangible development. , As previously indicated for other aspects, having a clear process to address foreign exchange will also be crucial to ensure a consistent allocation of profits among countries. It will also be of critical importance to define the applicable variables to adjust the economic differences existing among countries and industries to ensure a fair allocation of the Amount A related to "market users".

The allocation of residual profits can only work in practice if the determination of the profits that are allocated under the current system are determinable without conflict. Only if the amount of the routine profits and the amount of the non-routine profits can be clearly defined will the UA be considered as being useful in practice.

Taxand therefore urges that the standardized adjustments have at least to be bindingly agreed by all jurisdictions of the Inclusive Framework. Their application should be reviewed and challenged by the taxpayer in a further public consultation before implementing them to receive input from business and practice.

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;

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

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

The new nexus approach requires a completely different taxation framework for qualifying MNEs. Therefore, it will be advisable to establish unified mechanisms among countries adopting this new approach in order to tax qualifying MNEs, and also to release these MNEs from following the common corporate taxation framework (of course, only in respect of the profits derived from its business lines that qualify for the new nexus approach).

Most likely this could lead, among other aspects, to (i) define common tax forms; (ii) set up a new multilateral tax compliance authority; and (iii) create a new internationally harmonized legal framework to regulate the new approach.

Taxand suggests that to ensure that the reallocation of profits as per Amount A and Amount C is not double counted in two different jurisdictions, a mechanism will need to be implemented to allow for a correction to the tax base in the form of book adjustments of revenue and expense between the affected jurisdictions. It has to be made extremely clear which country, and within the country which companies, are the entities that will have the profits reallocated to them under this approach. In this respect, such reallocation should not create any deemed payment on which withholding tax or any other type of taxes (VAT/ GST) are applied. Moreover, there is the need to have clear acceptance in each country on applicability of such taxes for foreign tax credit or other relief mechanism (without needing to invoke MAP).

A further aspect that has to be investigated and agreed at the OECD level refers to losses. The relief mechanism should not only apply to profit, but also to losses that may be generated at the consolidated level.

However, by making adjustments to the tax base and not on tax credits or allowing tax exemptions, it may generally take the form of accounting adjustments. Therefore the current tax credit system will most likely not be affected. However, existing methods for eliminating double taxation should continue to be implemented for those segments of the MNE (or part of the business of the MNE) that do not fall within the scope of UA.

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; and

b. a determination of the quantum of the return (e.g., single fixed percentage; a fixed percentage that varied by industry and/or region; or some other agreed method).

Taxand strongly agrees and welcomes the approach to introduce pre-agreed standard margins. The majority of taxpayers do not mind paying taxes somewhere provided that they are only paying taxes once on the same income. With the effect of pillar 2 tax rates are likely to meet somewhere at a medium level so that distortion arriving from such an approach would be minimal.

As far as the determination of amount B is concerned, please refers to the comments already provided under point 4.

In addition:

- In order to determine the Amount B it is necessary to identify the type of activities commonly carried out by companies in the market country. It is not compulsory to ensure that all MNEs carry out these activities in the market country if the return allocated under Amount B is defined over the costs incurred by those baseline activities (as far as in cases where those activities are not performed in a certain market country, no result related to Amount B would be allocated to that country as no costs would be attributable to those activities in that country).

- It is necessary to ensure clear guidance to determine the costs related to the baseline activities carried out in the market country.

- In case of establishing fixed remunerations (as suggested, theoretically structured as a percentage over all the costs included to calculate the EBT and that are related to the performance of those baseline activities), it will be advisable to reach consensus by industry.

- There is a need for a clear definition of the activities that qualify for the fixed return. Nevertheless, even a clear definition will allow room for interpretation. Thus, the definition needs to be broad and leave room for the company/country to select the appropriate definition for the specified transaction (e.g., distinction between "limited risk" and "full risk").

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:

a. (unilateral or multilateral) APAs;

b. ICAP;

c. mandatory binding MAP arbitration?

Both MAP and APA procedures have been quite effective on a historical basis, but also very time-consuming and with a really slow resolution process. Regarding ICAP procedures, the few Taxand has seen were quite demanding to the taxpayer, involving high administrative costs of compliance.

It could be considered whether it is feasible to put in place a separate competent authority (maybe at OECD level) with a specific mandate to resolve disputes which arise on account of taxation from digital business.

As far as APAs are concerned, APAs might work for larger countries and MNEs, but are generally too expensive for the smaller countries and companies. In some countries, such as the US, there is a high user fee just for accessing the APA program that will make such a process difficult to consider on a wider basis. It can also be difficult to have a PE as a party to an APA proceeding. APAs can be an effective tool, but limited in their application due to constrained resources, time to complete, and cost.

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Where the UA is the central issue under a tax audit and the case is ultimately referred to MAP, Taxand proposes that it be mandatory for the parties to subsequently enter into an APA. Given the ongoing nature of taxation under the UA, an APA would be necessary in this case to resolve future years and to provide certainty for both taxpayers and tax administrations.

As far as ICAP is concerned, it may work but only if large countries and MNEs are involved. It would be too expensive for small companies and countries.

Taxand is the world's largest independent tax organisation with more than 550 tax partners and over 2,500 tax advisors in 49 countries. If you have comments or questions, please feel free to contact any of the following:

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Yours sincerely on behalf of Taxand,

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