Computer & Communications Industry Association
Tech Advocacy Since 1972

Computer & Communications Industry Association (CCIA) Comments OECD Consultation on Reports on the Pillar One and Pillar Two Blueprints

1. Introduction

The Computer & Communications Industry Association (CCIA) is an international, nonprofit association representing a broad cross section of computer, communications and Internet industry firms. CCIA remains dedicated, as it has for over 40 years, to promoting innovation and preserving full, fair and open competition throughout our industry. Our members employ more than 750,000 workers.[1] CCIA welcomes the opportunity to provide input into the OECD's public consultation on addressing the tax challenges of the digitization of the economy.

The OECD is the optimal forum to review the current international tax framework and to seek a global consensus-based solution. CCIA believes that the OECD should present a single, clear recommendation, rather than a selection of options for countries to choose from. With any changes, dispute resolution will be vital to maintaining certainty and consistency of approach. The OECD should require that any country adopting these new rules agrees to update mandatory binding arbitration for dispute resolution.

CCIA fully supports the OECD process to reach a consensus-based, multilateral solution, rather than the proliferation of digital services taxes. The OECD remains the best venue to address concerns related to the taxation of the digitalization of the economy.

2. Comments on Pillar 1

CCIA is broadly supportive of the Pillar 1 blueprint. However, there appears to be unanticipated ambiguity in the documents relating to segmentation and sourcing. Comments below offer suggestions to provide clarity. CCIA supports the approach on dispute resolution.

It is important that the final framework be straightforward and reasonable for taxpayers to apply and tax authorities to audit, thereby promoting certainty and preventing, to the greatest extent possible, intercountry disputes and/or multilayer taxation.

The withdrawal of unilateral measures as a precondition for agreeing Pillar 1 should be given greater prominence. This is noted towards the end of the document (paragraph 870), however this is a key concern for business to ensure that groups are not subject to multiple layers of taxation.

CCIA supports the marketing and distribution profits safe harbour to cap the allocation of profits to a market country under Amount A. This should in principle be an effective way to ensure that

[1] A list of CCIA Members is available here: https://www.ccianet.org/about/.

profits allocated to a market country are not excessive and do not allocate profits where sufficient profits are already allocated to that market under existing transfer pricing.

(a) Scope

Generally, the approach to businesses in scope appears reasonable. CCIA does not see a strong justification to differentiate between Automated Digital Services (ADS) and Consumer Facing businesses (CFB) in the design. CCIA does recommend that the definitions are as comprehensive as possible to ensure a level playing field between competitors. For example, if cloud services are considered to be ADS then this should apply to all cloud providers, not just a subset of the cloud market.

Further, dual use intermediate products and components are predominantly sold to businesses for integration into end products and should be entirely excluded from Amount A.

(b) Segmentation

Financial information used to implement this option should be financial data that is readily accessible for both taxpayer and tax authority rather than something that needs to be prepared specifically to implement these rules. This could include: (1) published and audited global consolidated financial statements; or (2) published and audited financial statements by segments.

The blueprint notes that segments in the financial statements may be used unless certain criteria are not met, in which case bespoke segmentation would be required based on "segmentation hallmarks."

These hallmarks add an unnecessary layer of complexity and ambiguity for both taxpayers and tax authorities. Financial statements reflect the way that a business views its operations and are prepared to meet the demands of shareholders. They are not prepared for tax purposes, and a more proportionate approach would respect that segmentation.

There are challenges with the preparation of new and/or bespoke separate financials based on hallmarks - a full value chain analysis would need to be performed in order to carve out a country-only or business-only P&L where this is not already in place – a highly complex exercise likely to lead to disputes. For example, central technology and R&D costs are generally not tracked by business or country, and attempting any sort of allocation of these costs would be complex and likely contentious. CCIA is concerned that this analysis is resource- intensive for both taxpayers and tax authorities through the review panel process, and countries within the panel may themselves not agree on how the hallmarks should be applied to a complex integrated business.

If there is a requirement for segmentation not contained in a MNE's financial statements, the methodology for preparing such segments should be formulaic and/or prescriptive (i.e. not subjective), such that there are no prolonged disputes. However, devising and agreeing such a methodology is likely to be time consuming. As such, CCIA strongly advocates that in order to have an implementable solution in quick order that no bespoke segmentation be required.

(c) Sourcing

The proposed approach on sourcing should seek to consider the place of end consumption as the country location for revenue allocation purposes wherever possible. Whilst for B2C sales this is generally reasonable, for many B2B business models this creates significant challenges (e.g. cloud, sales of products to 3rd party distributors, advertising, etc).

As a compromise, and to provide greater simplicity in application, CCIA recommends that a clear, unambiguous set of rules to identify the customer location are developed, with a clear hierarchy of how these rules should be applied. Businesses should be provided with a level of flexibility based on information they have available.

For example, the indicators of customer location under the ESS VAT rules could be used as a guide (these rules apply to electronically supplied services in many countries today, such as B2C digital business products). Whilst the ESS rules vary from country to country, it would make sense to look to a set of rules that are already applied by a number of countries, such as the EU ESS VAT rules.

For VAT (ESS) purposes, local law typically requires the seller to look to find two non-contradictory indicators of customer location. This normally involves looking at the customer's bill-to address and/or country of residence, as well as the default ship-to address, payment method issuer country and IP address country.

The purchaser must be defined as the first third party customer paying for goods/services, and not end users and consumers in the chain following any onward sales - this information is collected or reviewed for the first third party customer only. Although the blueprint proposes seeking to collect information on the onward use of such goods and services, this does not seem like a proportionate requirement, and many customers would not be prepared to provide this information for good commercial reasons.

There is also concern if the concept of "user" or IP location is used to allocate revenues, e.g. for advertising.[2] CCIA suggests that a simpler approach would be to allocate sales to the country of the advertiser (who is the customer), which is information companies would have for VAT purposes in most cases. Businesses generally do not collect data based on the location of end users or viewers, and a lot of work in terms of changing internal systems would be required to be able to do so. There are also data protection concerns if this data is required to be collected (e.g. compliance with the EU's General Data Protection Regulation). Furthermore, even if this data was collected, it would likely be highly inaccurate, as a large proportion of internet access is through VPN (including corporate networks) and so this will not reflect the actual location of users.

Finally, it should be clear that related party transactions are scoped out of the revenue measurement.

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[2] *See* A Preliminary Assessment of the EU Proposal on Significant Digital Presence (Jan. 2019), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3191787.

(d) Dispute Resolution

CCIA supports the proposed panel arrangement and staged approach to dispute prevention and resolution to simplify the audit and review process. This is an effective way to manage both taxpayer and tax authority time and resources and have any audits focus on key topics in an efficient manner.

It is important that the Pillar 1 system is easy to comply with and provides collaboration on transition relief. Anticipating the fact that the timing of adoption by jurisdictions will vary because of differences in parliamentary procedures and acknowledging that systems changes are likely inevitable, agreement should be reached to allow sufficient time for the adoption and administration of the new system in a manner that does not increase disputes or result in multilayer taxation.

2. Comments on Pillar 2

(a) General Concerns on Complexity

As proposed, the form of the Pillar 2 system is very complex**.** CCIA recognizes the difficult task of crafting a set of rules to design in a way that is globally applicable. However the blueprint contains a number of areas that would create a significant amount of additional work for MNE companies to be able to comply with as well as create new challenges for tax authorities to audit. It can be anticipated that many countries will have challenges in interpreting and applying these rules in practice. CCIA would encourage the OECD to consider ways in which these rules can be simplified.

For example, the requirement for jurisdictional blending creates a burden on groups to effectively create mini-consolidations for every country in which they operate and maintain multiple sets of books, which is not something that groups generally do today. Considering safe harbours based on global financial segment ETRs, or even allowing groups to apply the rules at an entity level (by taxpayer choice) may create a simpler approach. The rules should leverage existing financial information that groups already have available and should provide appropriate flexibility in this area.

The approach to IIR credits and timing differences also appears to be very complex to apply for MNE groups. CCIA recommends that using deferred tax balances would be a more straightforward approach since those numbers are largely already available and achieve a similar outcome. As a backstop, an additional IIR carryforward regime could be maintained for elective use by taxpayers who are willing to undertake the associated compliance burden.

Adjustments based on different local tax laws may create ambiguity, complexity and distortive effects (for example, on share based compensation). The approach should be simple to administer and uniform across all countries, otherwise it will lead to inevitable disputes.

(b) ETR Calculation

As the Blueprint notes, reference to financial accounting figures would fail to address the timing benefit intended to be produced by widely established domestic tax rules allowing immediate expensing and accelerated depreciation for tax purposes. Accelerated depreciation is fundamentally a timing difference and should not impact the total GloBE tax base over time. The Blueprint proposes two solutions: either to treat deferred tax liability as a covered tax with respect to depreciable property, or to compute the GloBE tax base by applying local tax depreciation conventions to the accounting base of assets.
While either the DTA approach or adjustment of the ETR for tax depreciation could address timing differences related to accelerated depreciation, we note that the DTA approach is more suited to comprehensively address timing issues arising from book tax differences in general. We would prefer to generally rely on deferred tax accounting principles, even if imperfect in dealing with temporary differences, because of the countervailing simplicity offered. The deferred tax model is not without its challenges. Therefore, a carry-forward regime will still be required for some taxpayers.

(c) Carry Forwards and Carve-Outs

First, the formulaic carve-out for tangible assets should be based on the carrying value of the assets rather than on depreciation.

A return-on-assets approach provides a robust method for determining a routine return to business investment. This is recognized by the OECD Transfer Pricing Guidelines (TPG), which provide that a return on assets is appropriate in evaluating the profits of manufacturing or other asset-intensive activities, and that cost-based indicators should be used only in those cases where costs are a relevant indicator of the value of the functions, assets, and risks of a business (para. 2.98 and 2.103 of the OECD TPG). A return-on-assets approach is also consistent with the U.S. GILTI rules, and with sound economic and finance theory (pursuant to which returns are earned on investments, not expenses). While there is a mathematical relationship between depreciation expense and carrying value, a “routine” markup on depreciation expense is likely to fall far short of a routine return on the carrying value of long-lived assets in a capital-intensive business. The use of a markup on depreciation expense in the carve-out, rather than a return on tangible assets, effectively penalizes capital intensive businesses in a manner that is inconsistent with the objectives of the GloBE rules.

Second, the formulaic carve-out for payroll costs should differentiate between different categories of employees.

Providing a higher percentage mark-up for certain categories of payroll costs (for example, strategic management and research and development activities) would be consistent with providing a functional routine return to the local activities of the Constituent Entity.

(d) Pre-Regime Losses and Benefits

Pre-regime losses and benefits of taxes paid by Constituent Entities of an MNE Group for the preceding 10 years should be carried forward to the GloBE rules.

The GloBE rules are technically complex and potentially apply to income that is subject to high rates of tax over time but appears low taxed in a particular period due to timing and other differences between local taxable income and profits before tax. To smooth out such timing differences, local covered taxes paid by Constituent Entities for the preceding 10 years should be carried forward to the GloBE rules, to the extent they exceed the minimum ETR. The obligation to establish and maintain carryforward accounts would be on the taxpayer; accordingly, there would be no additional administrative burden placed on tax authorities or taxpayers that did not wish to carry forward taxes from pre-regime periods. The carryforward of taxes should be indefinite.
This is particularly important for industries with long production cycles, such as high-tech manufacturing.

(e) Undertaxed Payments Rules (UTPR)

The UTPR should not apply to payments to a ultimate parent entity ("UPE") of an MNE because such application does not further the objectives of Pillar 2 and would operate as an infringement on the tax sovereignty of countries to determine the most appropriate manner in which to tax its resident MNEs.

UTPRs should not be applied to the domestic income of a UPE of an MNE for several reasons.

First, the objective of Pillar 2 is to ensure a minimum level of tax on foreign income earned by MNEs so as to address remaining international base erosion and profit shifting issues. The home jurisdiction of an MNE typically is the center of that MNE's economic interests and the place of ultimate management of the MNE. The home jurisdiction is more appropriately considered to be the natural location of the residual profits arising from the operation of the business, rather than a place to which profits are shifted to minimize tax.

Second, while all jurisdictions have a sovereign right to determine their own tax systems, that right is especially pronounced with regard to the system for taxing resident MNEs (as recognized implicitly by the design of the IIR, which permits the home jurisdiction of an MNE to impose a top-up tax on low-taxed foreign subsidiaries). The home jurisdiction of an MNE should have the right to determine the appropriate manner of taxing the domestic income of its resident UPE, balancing revenue concerns with tax incentives to encourage positive economic activity within its jurisdiction. Applying the UTPR to payments to UPEs would inappropriately encroach on the right of the home country to balance these domestic policy interests.

An obvious solution to this issue is to exempt the payments to UPEs from the UTPR. To the extent there is a concern that such an exemption could facilitate profit shifting, for example in cases in which the UPE is not located in a jurisdiction that represents the centre of its economic

activities, targeted rules could be designed to mitigate such concerns. For example, the exemption for payments to UPEs could be switched off for UPEs located in jurisdictions identified as "investment hubs" by the OECD, (FDI to GDP of 125%), unless the UPE's activities in its home jurisdiction met objective substance-based criteria (e.g., relative headcount or tangible assets).

(f) Interaction Between GloBE and GILTI

Pillar 2 does not yet provide how GloBE will coexist with GILTI (i.e., grandfathering). Securing GILTI grandfathering would be helpful in leveraging wider U.S. support to an overall agreement. This should be designed in such a way that any future amendments to GILTI are respected providing they do not alter the overall policy design of the rules.

GILTI has a policy objective consistent with Pillar 2: to tax foreign earnings that are otherwise subject to little or no tax. In effect, GILTI can in many ways be more onerous and impose more tax than the Pillar 2 rules.

Specifically:

- GILTI losses cannot be carried forward or back and timing differences can create other issues (since GILTI applies on an annual basis).
- GILTI has a broader scope: it applies to ALL of the subsidiary income (rather than as just a top-up tax). Therefore foreign tax credit limitations and other complexities of the US rules can increase the amount of extra tax cost.
- GILTI has a high ETR "threshold" of 13.125 percent which may be higher than the Pillar 2 minimum tax rate.
- The US GILTI regime in many cases may impose more tax on subsidiaries than the IIR to be adopted.
- Differences in blending, base, and carve outs for GILTI as compared to Pillar 2 are not expected to be substantial.

Proposals to change GILTI would likely make GILTI more onerous, including by raising rates and eliminating carve outs. Therefore arguments against grandfathering because GILTI may change are overstated.

DSTs are not contemplated to fall within the meaning of "covered taxes" under the Pillar 2 blueprint. If Pillar 1 is not fully adopted/DSTs repealed, MNEs will be faced with an inequitable tax burden (subject to DSTs with no relief for any amounts paid under Pillar 2). CCIA suggests this is considered further and DSTs be included as a covered tax.