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Mr. Martin Kreienbaum
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Dear Martin,

I am writing to you in your role as Chair of the Steering Group of the OECD Inclusive Framework ("IF"), as you and your colleagues consider the high-level framework for the work plan to be endorsed by the IF and G20 in the coming months ("IF/G20 Work Plan") on the tax challenges of the digitalizing economy. The purpose of this letter is not to argue the policy choices that have already been made (e.g., post-BEPS, is there a need for a further anti-avoidance regime?). Nor is our intention to give detailed comments or thoughts on any potential provisions at this stage. Rather, the purpose of the letter is to state a small number of high-level principles that Business at OECD's (BIAC) members feel will be crucial in guiding the project to a successful consensus that is both administrable and growth-oriented.

1. <u>The method for reallocation should be principled, sustainable and capable of being ascertained and applied by all countries and businesses</u>. We are encouraged that the May 2019 IF/G20 *Programme of Work on Developing a Consensus Solution* ("May 2019 Programme of Work") makes clear that the reallocation must be a principled one. But we do feel the outcomes of the project should be demonstrably grounded in principles that will, therefore, need to be clearly articulated in the IF/G20 Work Plan in order to reach a consensus that will endure. In line with our *Business Principles for Addressing the Tax Challenges of the Digitalizing Economy* ("BIAC Tax Principles"), we believe that these principles must take as their starting point the "long-standing and well-founded underlying principles of international taxation" including the arm's length standard, and must be "grounded in the concept of value creation" aligning taxation with where value is created. We understand that many countries believe that the current rules may not always proportionately allocate to where value is created; and we equally understand that some countries believe that totally new value creating factors have emerged. However, for the current system to be changed, and for all countries (including those who may lose net revenue) to agree on a solution to which they will adhere in the longer term, we believe that the basis for any change must be clearly articulated (including why, from where, and to where income will be reallocated), and must be capable of being applied by all countries (and businesses) in a way that leads to uniform, agreed results. (One final element of this principled approach should be that, in the interests of equity, provision will also be made for the allocation, or other recognition, of both costs and losses.)

2. Any reallocation to a destination country, whether by formula or under some modification to traditional transfer pricing methods, must be "modest" and "proportionate". We are encouraged to have heard this aspiration regarding "modesty" voiced by several countries, as well by the CTPA Secretariat. However, "modesty" (as with many things) will be in the eye of the beholder, so we would recommend guidelines that specify the permitted level of deviation from an ascertainable standard in order to anchor this result. This could be, for example, a relatively restricted range around a traditional arm's length pricing result, but could also be linked to other acceptable and verifiable benchmarks. We are not (at this point) suggesting what the range/benchmark should be, but believe this objective should be built into the IF/G20 Work Plan. In relation to the reallocation being "proportionate", we would simply note that a single "one size fits all" formula will not produce appropriate results across a range of very different business models, sectors and regions (including some where no reallocation would be the appropriate answer). In relation to this last point on proportionality, we recommend that the detailed workplan explore, and invite input on, solutions that would take into account such differences.

3. Any Pillar 2 Minimum Tax must be both reasonable and simple to apply and comply with, including being calculated on an aggregate rather than per country basis. While a minimum tax may be simple in concept, as the U.S. experience with its new Global Intangible Low-Taxed Income ("GILTI") minimum tax regime demonstrates, it will be far from simple in practice. And that is just the experience of one country applying such a rule unilaterally. The complexities increase factorially as multiple countries adopt the rule. While no tax can ever be truly simple, we believe that simplicity can be aimed for in the calculation of the tax, and in the rules on compliance. For example, we believe that requiring the minimum tax to be calculated under a per country rule, rather than on a worldwide (aggregate) basis could significantly complicate the calculation and administration of the rules. Likewise, a requirement for exact precision in calculating Effective Tax Rates will add an unnecessary burden not just for taxpayers, but also for tax authorities (in all IF countries, but especially those in emerging economies). We believe that these high-level parameters should be spelled out in the IF/G20 Work Plan. Additionally, to promote simplicity (or, at least, avoid further complexity), to the greatest extent possible existing CFC regimes should be modified or repealed to take account of the protection now afforded by any new minimum tax regime.

4. The denial of deduction rule/undertaxed payments rule should only apply to payments to an affiliate whose ultimate parent is not subject to a Pillar 2 Minimum Tax regime (to be defined on a "white list"). Again, the denial of deduction/undertaxed payment rule can be relatively simply expressed in conceptual terms, but would be enormously complex in practice – especially if it were to operate alongside minimum tax rules (as well as interacting with any Pillar 1 reallocation rules). We therefore recommend that the IF/G20 Work Plan makes clear that the undertaxed payment rule only applies to payments to other related-party recipients that are not part of a group that is subject in its parent jurisdiction to an acceptable minimum tax regime of the type proposed under the first leg of Pillar 2. For further ease of administration, we suggest there also be a "white list" of acceptable minimum tax regimes. We further recommend it be clear that this be a single, agreed-upon list, which can only be changed by consensus, and is maintained centrally by the OECD.

5. Significant strengthening of treaty dispute resolution provisions, including required agreement to a Mandatory Binding Arbitration provision, to be incorporated in a binding multilateral agreement. Eliminating double taxation must be a high priority if certainty and stability are to be restored, and, again, we were encouraged by the statements in and surrounding the May 2019 Programme of Work, which were in line with the BIAC Tax Principles. Further enhanced dispute resolution mechanisms will be required in relation to Pillar 1, as the potential for disagreement between countries that are gaining tax base and those that are losing it is very real. Disagreements under Pillar 2, especially in relation to any rules on the disallowance of deductions, can also be easily envisaged. We recommend, therefore, that the IF/G20 Work Plan specify four major requirements which will anchor all subsequent details on dispute resolution mechanisms:

    a. First, in order to benefit from any provision of the final agreement under either Pillar 1 or Pillar 2, a country must agree to apply agreed-upon Mandatory Binding Arbitration procedures (including multilateral dispute resolution measures in the case of some Pillar 1 options).

    b. Second, there must be a requirement for correlative adjustments to be made, so that businesses do not suffer double taxation.

    c. Third, any reallocation formulas cannot be unilaterally or arbitrarily changed. Any change must, thus, be agreed to by consensus.

    d. Fourth, countries must agree not to impose new taxes (and to repeal current ones) that are intended to tax profit (even if described as turnover), but are also claimed to be outside the definition of "covered taxes" in double taxation treaties, such as Digital Services Taxes and Diverted Profits Taxes.

   In order to ensure uniform understanding and adoption of these requirements, we suggest that the IF/G20 Work Plan make clear these requirements must be included in a binding multilateral agreement. Of course, we should also be clear that while dispute resolution is critical, so also is dispute prevention, and that will be achieved only through deep, comprehensive and clear agreement and guidance.

6. There needs to be – for the sake of both taxpayers and tax authorities (especially in emerging economies) – a relentless focus on, and commitment to, driving administrative simplicity into every aspect of the new rules. We have referred several times now to potential complexity, and to the possibility of disputes. Apart from our recommendations in the substantive areas set out above, we also recommend that the IF/G20 Work Plan mandate a focus on driving administrative simplicity. To expand on that a little (but only by way of a few examples that are not exhaustive) we suggest that the IF/G20 Work Plan require consideration be given to:

    a. Not requiring separate filings in every country to which income may be reallocated, but allowing for simplified notification, or reporting through the tax authorities in the jurisdiction of the parent company of a group.

b. Allowing payment of, for example, relatively small reallocated amounts to be made to, and distributed by, for example, the tax authorities in the jurisdiction of the parent company of the group (as well as providing a complete exclusion for truly de minimis amounts).

c. Making clear that any filing in relation to reallocation of profit, where the taxpayer would not otherwise be required to file any type of tax return in that country, will not trigger a requirement to file such other returns (for any type of tax).

We again believe that such provisions will be of help not just to taxpayers seeking to be compliant, but also to all tax authorities, <u>especially</u> those of emerging economies for whom such complexity can be a significant burden.

7. <u>In addition to the initial economic impact analysis, there should be on-going economic work undertaken throughout the duration of the project</u>. In a project of this scope and breadth – especially under Pillar 1 where some countries may be net losers of tax base, as well as in the interactions between the two Pillars – it is crucial that the potential economic effects on countries, business, and economic growth be as well understood as possible. We recommend that the IF/G20 Work Plan mandate such on-going work, as well as encouraging fruitful interaction with both academia and economists in the private sector in order to produce the best understanding possible of the economic ramifications of all aspects of this project. One criterion of the analysis should be to measure the effects on growth (positive or negative) to ensure that the project does not, unintentionally, adversely impact investment in innovation and production.

8. <u>Transition Issues.</u> While this goes slightly beyond the high-level principles for this first stage of the project, we do believe it important to acknowledge the importance of transition issues, particularly with a view to ensuring that during the transition phase additional tax is not levied as "compensation" for the switchover to a new system. These issues would include:

   a. A prohibition on exit taxes on outbound flows caused by the new rules.

   b. A recognition that existing withholding rules and new allocation rules should not result in double taxation.

   c. An understanding that the new rules cannot be used to create advantage for domestic businesses over foreign competitors.

We hope that these suggestions will be taken in the spirit in which they are intended, namely to ensure that by the end of 2020 we have a broadly agreed consensus within the IF on a framework that is administrable, and pro-growth. We understand that achieving the necessary level of detail in every area in order to ensure uniform application of any new rules will take time, and, so, we lastly recommend that the IF/G20 Work Plan mandate – where necessary – continued work on the new rules into 2021 (and beyond, if necessary) in order to achieve that.

We would be grateful if you felt able to share this with your IF Steering Group colleagues, and we do, of course, stand ready to answer any questions you might have about these recommendations. In

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addition, we also stand ready to work intensively and constructively with you, your colleagues, and the Secretariat of the OECD Centre for Tax Policy and Administration during the detailed phase of the work in 2020 (and beyond) in order to achieve a successful outcome to this important project.

Sincerely,

Will Morris

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Chair, Taxation and Fiscal Policy Committee,
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