ACCOUNTANCY EUROPE.

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Submitted to TFDE@oecd.org

Brussels, 12 November 2019

Subject: Public consultation OECD Secretariat Proposal for a "Unified Approach" under Pillar One

Dear Mr Bradbury,

1. Accountancy Europe thanks the OECD for the opportunity to provide its views on the specific challenges of producing a unified approach for the challenges under Pillar One. Please find below Accountancy Europe's comments on the issues and proposals raised in your consultation.

2. We look forward to the public consultation on Pillar Two, particularly as we believe that each Pillar cannot be considered in isolation and that each should form part of a cohesive single measure.

3. In our response to the *Public consultation – Addressing the Tax Challenges of the Digitalisation of the Economy* we suggested that the OECD should consider combining the best elements of the user participation and marketing intangibles approach, so we applaud the secretariat's efforts in doing so.

4. However, perhaps inevitably, the unified approach has resulted in a very complex proposal that incorporates a formulaic approach that sits alongside the arm's length principle.

5. In responding to the detailed questions in the consultation, our primary concerns are in respect of:

   a. Ensuring certainty for taxpayers and tax authorities alike

   b. Avoiding unilateral national measures

   c. Having a solution that is practical and capable of being operationalised by both taxpayers and tax authorities

   d. Avoiding both double non-taxation and double taxation.

6. We understand the concerns of some jurisdictions that feel that they are not getting appropriate taxing rights over the value generated by their citizens and consumers and commend the OECD on trying to find a solution to this within the international corporate income tax framework. However, we would also recommend consideration of other approaches that may lead to a similar shift of

taxing rights but with a reduced burden on taxpayers and tax authorities – such as the extension of the VAT system to cover such value creation.

Sincerely,

Florin Toma

President

Olivier Boutellis-Taft

Chief Executive

About Accountancy Europe

Accountancy Europe unites 51 professional organisations from 36 countries that represent **1 million** professional accountants auditors and advisors. They make numbers work for people. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond.

Accountancy Europe is in the EU Transparency Register (No 4713568401-18).

Question 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)?*

7. We consider that it is first necessary to define 'interaction with consumers/users'. This will be difficult but a clear definition is necessary to avoid ambiguity and different interpretations by individual taxpayers and tax authorities. To ensure the efficiency of the system, the rules in the proposed "Unified Approach" must be as clear and simple as possible and there must be consistency in their application by all taxpayers and all tax authorities. This would, at the same time, limit as much as possible double taxation issues which are detrimental to international trade and economic growth**.**

8. We believe that the starting point for defining the MNE group should be the consolidated financial statements. Generally speaking, global financial reporting standards are robust in determining which group entities should be consolidated and there is a degree of commonality between different reporting standards on this matter..

9. An effective solution should be equally applicable to all entities and, consequently, should cover multi-sided business models and sales to intermediaries. The solution should be equally applicable to MNE's making direct sales, using commission agents and limited-risk and fully-fledged distributors.

10. However, we acknowledge that including sales made through distributors will be difficult because the MNE would not necessarily have information about the location of the final consumer and intermediaries' margins.

11. A well-designed proposal should be suitable for entities of any size. However, as the current proposal is complex, we would recommend that the scope is initially based on the same €750 million threshold as for BEPS Action 13. Where tax payers are covered by these provisions, we believe that the efficiency of the "Unified Approach" would be enhanced if there would at least be an option for the MNE to centralise the administration and compliance at the level of one group entity, subject to the ability to prove locally in an easy way that all obligations are fulfilled.

12. As for the above, the ideal solution should cover those businesses that meet the thresholds and have significant user participation and / or marketing intangibles. We do not, therefore, think a carve out for certain sectors should be necessary.

13. A possible rationale that we can see for a carve out is to avoid certain businesses going through the exercise of performing the calculations to prove that they are outside the scope of the provisions – thereby saving costs. However, even in this case, the business would have to review its business model on a regular basis to ensure that the carve out was still valid.

Question 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?

14. Determining the sales of a group in an individual jurisdiction may be challenging. It is not always easy, or even possible, to trace the identity of the final consumer. In cases where there are intermediaries, clear rules are needed to determine where those sales should be attributed. This also applies where sales are performed via another company, and not directly, to the final consumer.

15. An example of the analysis done on the sales factor is the work of the European Union on the CCCTB. Ultimately, it was decided to use sales by origin because of the practical difficulties of tracing the destination of sales.

16. Defining and calibrating country specific sales thresholds is very difficult. Amongst the national digital tax proposals there is a very large difference in the thresholds that countries choose. For example, the UK and Italy, which have broadly similar GDPs, have proposed thresholds of £25 million and €5 million respectively. This perhaps indicates that such thresholds are based on national policy issues rather than empirical considerations.

17. However, as current international tax law provisions often require a significant degree of economic activity before they apply, it would be logical to provide for a single national threshold in this instance to increase certainty. Whatever the level of the threshold, we believe that the tax would have to be economic to administer from the jurisdiction's perspective.

18. The phrase 'smaller economies' implies a form of weighting based on, perhaps, GDP. However, such measures may not accurately reflect the potential for consumers in a particular jurisdiction to interact with the MNE – the existence of local competitors, internet access and many other factors could also have a big impact. This is an area that requires further empirical research.

19. Presumably the rationale for having country specific sales thresholds is to save administration costs both for businesses and tax administrations. However, if the proposals were limited to only the largest MNEs, as indicated in our response to Question 1, it is more likely that these companies would have the systems and resources to prepare the calculations and pay the tax due to the correct jurisdictions (albeit the smaller ones may still prefer simplified, 'safe harbour', rules). It would then be up to national governments, through the inclusive framework, to say if there is a threshold below which it is uneconomic for them to control/audit the quantum of the tax receipts.

Question 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, standardised 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?*

20. As mentioned above, we believe that consolidated financial statements are a suitable basis for determining the scope of the MNE. We also believe that they are the most appropriate basis for determining the base level of group profit.

21. There is a large degree of commonality between the most widely used financial reporting standards – International Financial Reporting Standards (IFRS) and US Financial Accounting Standards (US FAS). Additionally, many national accounting standards follow the same basic accounting principles and practices of these standards.

22. However, there are still numerous differences between IFRS and US FAS, and other national generally accepted accounting principles (GAAP). Many of the key differences are highlighted in a PwC report[1], but there are others. Consequently, some standardised adjustments would be required to align group profits in such areas as:

    a. income recognition

    b. amortisation and depreciation

    c. financial instruments and impairment thereof.

23. Only recurring group profits shown in the consolidated financial statements would be relevant to the calculation of Amount A. Indeed, it is likely that consumers/users are not significant in the creation of non-recurring profits such as capital gains or other non-recurring items.

24. Another adjustment would be in respect of joint ventures and associate's profits in the consolidated financial statements. In these circumstances, only a percentage of profits will be recorded in the consolidated financial statements, but the underlying entities will have normally already been taxed on their respective full profit.

25. There are also issues with application of international financial reporting standards within a group where the treatment at subsidiary (national) level – which may form the basis for taxable profits – is different for the same item in the consolidated financial statements.

26. Whereas we believe that consolidated financial statements are the best basis for determining group profit, we do not believe that consolidated accounts are a suitable basis for determining the amount of sales per jurisdiction under Amount A.

27. For example, *IFRS 8 Operating Segments*, the international standard that is most likely to result in useful information for this purpose, requires high-level information on turnover and certain expenses by segments. However, the entity decides the appropriate segments and may aggregate segments if it believes this to be appropriate. This is not sufficiently detailed to provide turnover figures for each jurisdiction in which the entity operates and also would not normally split turnover between business to consumer and business to business supplies.

28. Additionally, there may be differences between turnover and expenses under *operating segments* of the consolidated and subsidiaries' financial statements, due to:

    a. differences between IFRS and national GAAP, and respective adjustments

    b. intragroup eliminations

[1] https://www.pwc.com/us/en/cfodirect/publications/accounting-guides/ifrs-and-us-gaap-similarities-and-differences.html

c. different IFRS treatments at entity and group level, even when all entities in the group report under IFRS

29. It may be that the country by country filings under BEPS Action 13 could assist with determining turnover figures for each relevant jurisdiction but the different bases on which the country by country returns are based makes reconciliation with group profits very difficult. It would be useful to have a country by country statement that is reconcilable to overall profit and to tax filings and the Global Reporting Initiative's proposed tax standard could be a helpful tool in achieving this.

30. It would also be useful to have some standardisation of jurisdictions' tax bases to avoid the risk of tax base shopping and to reduce administrative burdens on taxpayers and tax authorities. A useful summary of the sort of adjustments required can be obtained from reviewing the items covered in the European Commission's proposal for a Common Corporate Tax Base[2].

31. In respect of the question of operating segments and regional profitability, we believe that deriving suitable rules into the calculation of Amount A to deal with this issue would be very difficult.

Question 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?

32. It is practically very difficult to determine what income is derived from residual profits generated by a consumer facing MNE and any amounts derived will be subject to disagreement.

33. Business line segmentation would require that businesses perform a detailed structural analysis and put even greater resources into trying to allocate the profits arising from hard to value intangible assets - which is already a significant issue with the proposal.

34. A solution based on sound economic theory, but which is simple and certain, is attractive even if it doesn't exactly equate to the underlying economic substance as long as it provides certainty and reduces the possibility of disputes.

Question 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 their interaction with consumers/users;

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

35. In principle, the mechanisms introduced for the elimination of double taxation should avoid administrative costs. Where possible, double taxation should be avoided, not resolved, as businesses should not be waiting 5 or 6 years to recover taxes effectively paid twice.

36. One of the difficulties with the new nexus is determining who will pay the tax that arises in jurisdictions where the MNE has no permanent establishment.

[2] https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_685_en.pdf

37. MNE's will normally introduce intra-group recharges to reallocate the taxes charged under the new nexus rules to the relevant entities within the group. It would be logical that loss relief should follow the same internal recharge structure that the reallocation of profits follows. The Unified Approach should also include mechanisms to ensure that existing tax losses in a jurisdiction are capable of being offset against the profits allocated to that jurisdiction under the new nexus rules.

38. For Accountancy Europe, there should be rules that oblige jurisdictions to grant relief for the tax assessed in another jurisdictions as a result of the new nexus rules. In our opinion, this aspect is far more important than the mechanisms by which double tax relief is granted (i.e. tax credits), especially as these mechanisms generally function adequately.

39. However, the mechanisms will require enhancement in order to collect all the tax paid via, for example, distributors and branches.

40. Whatever the apportionment method used to allocate taxing rights to jurisdictions, jurisdictions should be bound by the Multilateral Instrument to accept the apportionment. Where disputes do arise jurisdictions must be obliged to enter into a formal dispute mechanism, discussed in more detail under Question 7.

41. A multilateral convention is required to obviate the need for revisions to treaties, which would take years. The multilateral convention should not contain jurisdictional options – for example over the formulas used. Where states are given such options, as occurs with corporate income tax in the United States, double taxation will arise. There needs to be a simple formula, applicable to all.

Question 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).

42. Although fixed remunerations are an economic fiction and may result in economic inequity, we believe that they may be of use in building a system that covers all bases and gives certainty.

43. We have no views on how to determine the quantum of the fixed remuneration but stress the importance of defining the activities that would be covered by the fixed remuneration, in particular to reduce the possibility of double taxation of activities also covered by Amount C.

Question 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 their interaction with consumers/users;

a. (unilateral or multilateral) APAs;

b. ICAP; and

c. mandatory binding MAP arbitration?

44. Following on from our response to Question 6, it is necessary to clearly define the amounts covered by Amount B and by Amount C to reduce the real likelihood of individual jurisdictions making their own definitions and capturing income taxed in another jurisdiction.

45. The first aim is to avoid disputes. Apart from clear definitions as mentioned above, we believe that the most effective tools for avoiding disputes are bilateral or multilateral Advance Pricing Agreements (APAs). These provide the necessary legal certainty but are currently time consuming to negotiate. Consequently, we would recommend that the OECD examines mechanisms to introduce an abbreviated process for agreeing multilateral APAs.

46. In respect of Multilateral Agreement Procedure (MAP), we believe that this is a valuable tool but that it needs to be strengthened. Currently, not every jurisdiction accepts arbitration, and this is likely to become more of an issue under the proposed new nexus rules. Additionally, arbitration should be compulsory and binding and not allow the jurisdictions the fall back of demonstrating that they have made their best efforts to reach agreement. There should be a mandatory time limit for the process, as included in the European Union's Directive[3] on tax dispute resolution mechanisms.

47. The International Compliance Assurance Programme (ICAP) is also an interesting development but requires further development before it will really make an impact. At the moment, there are too few companies and countries that take part – including an absence of developing economies. It could be that more companies could be attracted to the programme if, for example, penalties were avoided on disputed tax where the companies could prove complete disclosure of relevant facts.

    Perhaps more jurisdictions could become involved with the development of a standard audit procedure, as we believe that the lack of an agreed audit standard leads to tax jurisdictions not trusting the methodology of other administrations. Confidence between tax authorities could also be enhanced if more companies were encouraged to seek independent, external assurance of their tax function, which again could be incentivised by the waiving of penalties in situations where the company in question has demonstrated that it has made every practical effort to produce an accurate tax return.

48. It is also possible involvement in ICAP could be linked to the streamlined multilateral APA approach mentioned above.

[3] COUNCIL DIRECTIVE (EU) 2017/1852 of 10 October 2017 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L1852&from=EN