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Public Consultation Document
Addressing the Tax Challenges of the Digitalisation of the Economy

Joint comments by economiesuisse and SwissHoldings

Dear Sir,

economiesuisse, the Swiss Business Federation represents approximately 100,000 companies from all business sectors and regions of Switzerland with a collective work force of some 2 million people. SwissHoldings represents the interests of 57 Swiss-based multinational enterprises from the manufacturing and service sectors (excluding the financial sector). These comments are additionally supported by ICTSwitzerland, the umbrella organisation for the digital economy in Switzerland.

We thank the OECD for the opportunity to provide comments on the consultation document on Addressing the Tax Challenges of the Digitalisation of the Economy and are pleased to provide you with our analysis and comments, and fully support the discussion of the proposals on a without prejudice basis.

We have structured the document by providing concise responses to the specific questions posed in relation to revised profit allocation and nexus rules as well as the global anti-base erosion rules (Appendix 1) followed by a detailed walk-though of our comments on the public consultation document (Appendix 2).

Karine Uzan Mercie and Annabel Collett intend to participate in the public consultation on 13 and 14 March 2019 in Paris as representatives for SwissHoldings and economiesuisse. In addition, Avni Dika Head TP of a big SwissHoldings member company could contribute with his transfer pricing knowledge. We would also be pleased to set up a small-group meeting with you to discuss our comments in more detail, should this be of interest to you.

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We hope our submission is helpful and we look forward to continued ongoing discussion on these important topics.

Yours faithfully,

Dr. Frank Marty
Executive Board Member
economiesuisse

Dr. Gabriel Rumo
Director
SwissHoldings

Appendix 1: Executive Summary

The key points that we would like to raise are the following:

1- **Do not mix tax challenges arising from the digitalising economy with concerns about tax avoidance**. The global anti-base erosion proposals discussed in pillar 2 are totally independent from the tax challenges of digitalisation and should be excluded from the final proposal and dealt with separately
2- **Assess what is not working now to better understand what will work tomorrow**. Before we change the rules again, for some or all, and before we depart from the arm's length principle or DEMPE analysis, we need a clear assessment of what is not working today with the current set of rules as modified by BEPS action 8-10 and why the OECD believes tax is not levied where value is created under the current rules
3- **Anticipate macro-economic impacts of shifting right to tax to market jurisdictions**. It would be critical to make transparent any potential net revenue effects of such proposals for different countries before implementation. Rewarding countries for having large and growing consumer markets, while hitting medium-to-mature countries with a smaller population scale but appetite for innovation will have significant macro-economic impacts and will have significant ramifications on investments.
4- **The user participation approach is not a long-term solution**. The user participation concept does not deliver a clear-cut ring fencing of the digital economy if (i) the current proposals are further extended to digital activities of traditional businesses, as it would result in hyper segmentation and complexity, (ii) more and more businesses are similarly affected in the future
5- **Even if this reduces chances of a consensus, set now clear definitions of any new concept**. Before the business can validly comment on the proposals, precise definitions (highly digitalised businesses, market, users value contribution, users participation, …) and allocation keys shall be set, as they are the only crucial element of any proposal
6- **Do not complexify the complexity**. All proposals have to be tested against the Ottawa principles and have to be manageable to avoid complexity and controversy
7- **Balance the risks of the proposal with integrated dispute resolution process**. A fast track dispute resolution process must be part of the proposal and not proposed later or separately

Global Context

Since the 2018 interim report, the initiative to address "the Tax Challenges of the Digitalisation of the Economy" appears to have emerged into a much broader attempt to generally overhaul long established international tax rules well beyond the current tax challenges of digitalisation.

The proposals described in the consultation document have the potential to fundamentally change the international tax framework with far reaching consequences for international business and for national tax revenues. Furthermore, fundamental changes in relation to the corporate income tax framework may have knock-on implications for other taxes (including indirect tax) and customs. While we understand the pressure that the OECD faces, some challenges and instability the tax system is going through and trust that the OECD is the best place to handle the debate and provide potential international guidelines with the broadest consensus and chance of success, this significant broadening of the scope and the major repercussions of the proposed measures are so significant that we are deeply concerned by the extremely short consultation period granted to formulate comments by the business community and hope we will have many other opportunities to interact with the OECD to better understand all ramifications the current proposals may have on all parties.

We are also somehow surprised that there is no deeper analysis in the report, as to why the current rules no longer work and why BEPS actions are failing to remedy potential problems (e.g. there is lack of analysis as to where current rules lead to over-allocation of profits that could and should be re-allocated differently in the future). Also, there is no sufficient analysis provided of what has changed as a result of further digitalisation of businesses that merits changing existing global taxation rules. Further analysis would allow the business community to better understand what the most appropriate measures would be to resolve such current perceived issues and avoid having another drastic change in the international guidelines in the short term.

In particular, while we also support that ring-fencing the digital economy is almost impossible to achieve, we note that any solution must achieve what we understand is the perceived issue in relation to digital business activity. There must be sufficient agreement that the proposed solution most impacts business models which were not anticipated in earlier discussions on the international tax system (i.e. highly digitalised businesses).

The consultation covers a review of the profit allocation and nexus rules, as well as the ongoing work on remaining BEPS challenges. According to the consultation document, these two issues are distinct but intersect and a solution that seeks to address them both could have a mutually reinforcing effect. Therefore, both issues should be discussed and explored in parallel. At the same time, the separation of the consultation into two very distinct pillars makes it clear that there is not one singular solution.

The proposals in both pillars are deriving from the need expressed by some countries to continue working on the digital economy challenge but the outcome that both can have on income allocation are very distinct and not at all correlated. On the one hand, the application of new profit allocation and nexus rules discussed in pillar 1 is disconnected from any ‘BEPS’ issue. It is in fact a re-negotiation of taxation rights among countries and shall not bear the ‘BEPS’ label. On the other hand, the global anti-base erosion proposals discussed in pillar 2 are totally independent from the tax challenges of digitalisation. They aim to meet potential remaining BEPS challenges by introducing non-territorial approaches in order to limit tax competition among countries. Where we understood that BEPS was aimed at fighting double non-taxation, we are surprised that some countries are now intending to set a uniform minimum rate irrespective of the local market conditions the infrastructure provided by countries and the general attractiveness as a business location.

Also, the combination of these two distinct pillars reinforces to the public the message that all MNEs are using digital means to escape taxation, which is a very inappropriate message. Hence, we recommend making it explicit that pillar 1 and pillar 2 must not stand together as two parts of a single initiative but that the two pillars have to be discussed and implemented separately and independent of each other.

We also wonder if the content within the global anti-base erosion proposal could not be seen as a failure of all output from the BEPS action plan and be very counter-productive to the work the OECD has performed so far.

We believe that inclusion of a fast track dispute resolution process could be a very attractive element to a proposal to incentivise businesses to look more favourably at the proposed ideas, in particular where it could also apply with non-treaty countries and discourage countries to enter into harmful disputes for taxation. We understand that BEPS was aiming at eliminating non-taxation; it should not ultimately end up with a new set of rules creating double taxation, which is a barrier to growth and investment.

Last but not least we need to make sure that the new guidelines, if any, are workable in terms of (i) calculation, (ii) audit, (iii) assessment in all countries, as additional complexity on top of an already very difficult technical environment would entail controversy and be a barrier to trade. The current guidelines need to be compatible with all Ottawa principles.

Revised profit allocation and nexus rules

Questions for public comments (section 2.4, page 23)

1. *What is your general view on those proposals? In answering this question please consider the objectives, policy rationale, and economic and behavioural implications.*

   According to the consultation document the three proposals explicitly seek to expand the taxing rights of the 'user' or 'market' jurisdiction, even if there is no physical business presence in such jurisdiction. What is a 'market' and what is the value of a 'market' is therefore the starting point for commenting the proposed guidelines and it will be important to define and to get a clear and deep consensus on such notions, which does not transpire clearly yet from the consultation document.

   We understand that certain countries, which are often less able to attract R&D activities, international champions than others or lack infrastructures, feel that the mere fact of offering a 'market' for goods and services and consumers comments should attract income. This confirms our view that the first pillar of this project is inherently a re-negotiation of taxation rights among countries. This emphasizes the need for an efficient dispute resolution process.

   For businesses, assuming the rules are clear, manageable, and as we see a convergence of taxation rate across the world, the shift of taxing rights to the market jurisdictions could theoretically be neutral. This is not true for the countries. Rewarding countries for simply having large and growing consumer markets while hitting medium-to-mature countries with a smaller population scale but appetite for innovation will have significant macro-economic impacts that are very difficult to predict and will have significant ramifications on investments. Therefore, it would be critical to make transparent any potential effects on net-revenue of such proposals for different countries before implementation.

   We support previous conclusions that corporate income tax should focus on the supply side (place of origin) and that mere consumption should not give rise to direct taxing rights. Framework conditions such as a reliable public infrastructure, effective public education and a well-functioning legal system cost money. Businesses taking advantage of such public investments should also contribute to their financing. Only then are countries incentivized to provide the necessary framework conditions for businesses to thrive. Such incentives are of special importance in the context of the digitalizing economy which, if nurtured appropriately, creates new opportunities for global growth and prosperity.

   Recent work by Copenhagen Economics has indeed highlighted that countries with large exports, and in particular if a substantial part of the value is derived from R&D intensive goods and services, would lose considerable tax revenues if the residual profit was allocated, in full or partly, to market countries. How would such countries sustain investment-friendly infrastructures?

   We are also convinced that when addressing the taxation challenges due to digitalisation, it is important to strike a balance regarding the revenue consequences for net-exporting and net-importing countries. Otherwise, it will not be possible to achieve a global consensus, which is the key success factor to the initiative.

   To our opinion, if the true issue is allocation of income between source and residence or production and market locations, this arbitrage may ultimately not be the role of profit taxation, but of consumption taxes.

User participation approach

The user participation approach has the explicit objective of targeting a small subject of highly digitalised businesses. While questionable with respect to the neutrality principle, this aim brings with it the complexities of defining the activities in scope and the exceptions. In addition, it either ring fences some multinationals or ultimately will apply to all highly digitalised segments of other businesses and results in hyper segmentation of the activities of a business. We do not believe that the concept of user participation is able to deliver the clear-cut boundary necessary to define the scope of this approach in both cases. We also expect significant divergence between countries in definitions used in domestic law, based on different fact patterns for different countries. Thus, the user participation concept entails the significant risk that the scope of the proposal would be ambiguous and potentially much broader or complex than anticipated and hence that many traditional businesses could be affected with unclear or overcomplex rules and double taxation.

Moreover, we expect every business to become more digitalised in the short-to-medium term as technology continues to advance. This includes the widespread use of data analysis, customer feedback, automated data feeds, computer-mediated transactions, customized products and services, targeted offers, and more. This should be encouraged as a stepping stone to efficiency and growth. While many traditional industries are currently going through some sort of digital transformation, their business model genuinely stays the same and its main value drivers do not suddenly shift to the market jurisdiction. Firms of the traditional economy may open new communication channels to interact with their costumers, automate certain back-office processes and change their distribution models (for example, by introducing online marketplaces). However, the existing essential value generating factors keep their relevance and how companies interact with their customers using new technologies should not be the basis for a re-interpretation of corporate tax principles or promote a new type of taxation. Hence, the tax framework should not imply that technological progress causes traditional businesses to suddenly be exposed to a totally different set of tax regulations. This would be counterproductive to driving technology adoption and digital advancement and thus not conducive for global economic growth, productivity and prosperity.

Marketing intangible approach

This approach assumes a marketing intangible to have an intrinsic functional link to the market jurisdiction and thus allocates the value of this intangible (potentially completely) to the market. However, it seems obvious that the value of such an intangible has to be created by someone and we remain unclear as to why the DEMPE approach and arm’s length principle could not apply in this approach. To this point, we reiterate that any proposal relating to allocation of residual profit from marketing intangibles to local markets should not be a re-allocation of all profit deemed derived from marketing intangibles.

The consultation document recognizes that marketing intangibles like favourable attitudes in the minds of customers or customer information and data are the result of an ‘active intervention of a firm in a market’. Further, the consultation document also recognizes that digitalisation and lower communication costs have increased the opportunities for a modern enterprise to reach and interact with customers in a given market remotely. Therefore, if the active intervention of a business creates the value of a marketing intangible remotely, the respective profits should be allocated to this remote jurisdiction where the employees executing these interventions or at least some intervention from the company are based. It is business decisions that determine the value of marketing intangibles and success in generating such values determine whether a business is profitable or not. Thus, a functional analysis should allocate at least part of the value created in the form of such marketing intangibles to the jurisdiction from where the relevant employees operate. We are thus not very clear on why this approach would drastically differ from the existing guidelines except that there would be a systematic residual profit split approach and a part of the residual profit can be allocated to the market jurisdiction using the nexus rule. This does not seem to depart from what a DEMPE approach would give for the vast majority of the income, unless the value attributed to 'the market' is intentionally disproportionate (which we understand is not the intention of the proposal, with only an element of the residual profit attributable to marketing intangibles allocated to local markets).

In some aspects we still have difficulties to understand the underlying approach. For example, the intrinsic functional link of a marketing intangible to a singular market jurisdiction has to be questioned. The perception of a brand often cannot be considered on an isolated domestic level – if a brand is popular in the US, it may lead to knock on popularity in many other countries for example through the export of cultural goods such as movies or music. Similarly, a common language and shared cultural area reflected in shared TV-stations, Newspapers, Theatre, Movies and Literature may lead to significant cross-border effects of marketing intangibles. Favourable or also unfavourable attitudes in the minds of customers regarding certain products in Germany may knock on fast to the German speaking part of Switzerland, attitudes from France to the French speaking part and from Italy to the Italian speaking part of Switzerland.

We also wonder how B2B coupled with unrelated B2C and fully integrated B2C businesses could be treated under the proposed approach.

From the description of the proposal one could infer that the arm's length principle could be replaced by a very subjective quantification of the value of the contribution of a 'market' in the value chain of a business and it is hard at this stage to determine if that would be a progress or not in trying to adapt the international tax principles to the growing digitalised businesses.

Significant economic presence

The proposal in relation to significant economic presence is not in line with the objective to recognise value created by a business's activity or participation in user/market jurisdiction and is departing from all existing principles. Instead, it aims to determine a nexus from a broader range of circumstances, thus promoting the role of additional taxation in the source state, rather than responding to the perceived issues of arising from the digitalisation of the economy and concerns around intangibles. As such, we do not consider that it is possible for this significant economic presence proposal to be combined with either of the other two proposals under discussion.

With respect to profit allocation, the proposal does not provide a sufficient level of detail on how it would be applied in practice. Sales allocation denies differences in profitability and does not allow a fair apportion of tax between jurisdictions. We therefore cannot comment on specific aspects of that proposal. We support the statement in paragraph 13 of the consultation document that 'any solution that seeks to address nexus must also address the closely-related issue of profit allocation, or it is bound to fail - with likely increases in uncertainty and controversy without a meaningful increase in income allocation'.

Generally, we are very sceptical of formulary apportionment. We believe that global formulary apportionment would require a level of cooperation among countries that is not achievable. There would need to be agreement among countries on the details of a global corporate income tax and on an allocation key. The challenges faced for over a decade by the European Union to reach agreement on the Common Consolidated Corporate Tax Base is indicative of difficulties that may arise on a global scale, as the devil is not on the principle of allocating income using a key; it is in defining the key.

2. *To what extent do you think that businesses are able, as a result of the digitalisation of the economy, to have an active presence or participation in that jurisdiction that is not recognised by the current profit allocation and nexus rules? In answering this question, please consider:*
    i. *To what types of businesses do you think this is applicable, and how might that assessment change over time?*

We continue to think that the arm's length principle should be the basis on the international tax system and that most of the taxable income generated by all types of businesses can be ruled by this principle.

We have developed in the detailed section examples where we think it would be extremely counterintuitive to allocate income to a jurisdiction where there is no function performed, no asset owned and no risks taken. It is also difficult to anticipate how the rules could work in a franchise environment, in the starting phase of the business and other common yet non-standard business set-ups. We also note that 'limited risk distributor' can be interpreted in many ways and should not be considered as a problematic business model in all circumstances. On the basis of a proper functional analysis, the profit allocation for limited risk distributors is benchmarked and thus should be considered 'right and fair'; i.e. a proper functional analysis is not solely a DEMPE analysis for such entities, which results in little to no allocation of profit.

If businesses today have an active presence or participation by users in another jurisdiction, this seems to be possible exclusively by offering users some kind of new and useful application of technology. Technology IP is recognised by the current profit allocation and nexus rules based on the location of DEMPE functions. We note that function analysis based on DEMPE functions is still a relatively new area in transfer pricing which is still being adopted across the business community. Further, the BEPS measures (e.g. Actions 8-10) have only very recently been implemented, but certainly affect the allocation of the value of intangibles. As we have not yet seen in the full impact of BEPS, it seems impossible to tell for which businesses 'the current profit allocation and nexus rules' does not recognise technology IP adequately.

It is also difficult to understand why the distribution pipeline chosen by a business (local limited risks retailers or online platform) could have an impact on the value deriving from the market jurisdictions unless one negates the transfer pricing principles applicable to local limited risk distributors.

   ii. *What are the merits of using a residual profit split method, a fractional apportionment method, or other method to allocate income in respect of such activities?*

Any new proposal regarding profit allocation must be measured against this current standard. Even after full implementation of DEMPE functions and the BEPS measures the international tax system will not be perfect. There might be cases where 'value created by a business's activity or participation in user/market jurisdictions' is not recognized (type 1 error). However, a function analysis based on DEMPE and risk assumed seems way more accurate and in alignment with value creation than any of the discussed new profit allocation and nexus rules so far as suggested in the consultation document. Due to administrative viability any residual profit split or fractional apportionment method will necessarily be based on very generic assumptions about the value created by users or the value of marketing intangibles. As a result, the risk that a local affiliate in the user/market jurisdiction is allocated an inappropriately large share of the group's profit seems considerable (type 2 error). In order to count as progress in terms of the aim of profit taxation where value is created, the decrease in type 1 error due to any new measure must be smaller than the increase in type 2 error. It cannot be that a reduction in the risk of type 1 error is bought at the cost of much greater increase in the risk of type 2 error.

3. *What would be the most important design considerations in developing new profit allocation and nexus rules consistent with the proposals described above, including with respect to scope, thresholds, the treatment of losses, and the factors to be used in connection with profit allocation methods?*

One of the most important design considerations should be to limit the administration cost and compliance effort. For businesses this includes monitoring the implementation and thresholds for the proposal, filing obligations where entities are (and are not) required to pay tax and also payment and collection mechanisms. This requires transparent rules, based on clear and easy to understand principles.

With respect to the user participation approach the critical issue would be to determine the value that is generated from user participation. This would be necessary to determine what portion of non-routine returns should be re-allocated, as well as to determine the allocation of this proportion to the different user jurisdictions. It would be necessary to recognise:

- A mere collection of data which is not accessed, analysed or acted upon in any other way (for example due to bad data quality or regulatory reasons) does not lead to value creation for a business.
- User participation may have negative effects on the value of a brand. For example, posting of inappropriate content online leading to damage to a social media site or sale of criminal goods.
- Value attached to a user participation is likely to vary considerably by country. Any proposal needs to take into account the variation in user location and its impact on deriving value for a business.
- The value also depends on the level of engagement the frequency of the interaction.

With respect to both the user participation and the marketing intangible approach it would be necessary to determine the proportion of the residual profit to be re-allocated. Non-routine returns would have to be separated into those attributed to user participation or marketing intangibles relative to those attributed to trade intangibles. The consultation document recognizes this as an important challenge since these two types of intangibles are often interconnected. While recognizing this challenge, the proposals in the consultation document seem to discount the importance of technology IP in value creation. The generation of technology IP is a non-routine function and should earn a share of the residual value reflecting its importance of operating a digital as well as a traditional business. The remote participation in a market enabled by digital means but without a taxable physical presence – seen as the key issue in the digital tax debate – seems necessarily based on technology IP. Companies aiming to achieve a sustained engagement and active user participation must solicit and incentivise users to do so by providing a useful service or experience (social media platform, search engine, online marketplace) in the form of an application based on technology IP. In footnote 6 of the consultation document this is recognized by stating that 'such consumer data is typically acquired in exchange for free services, such as free search functions, free emails etc.' Hence, any user participation/marketing intangible and the monetization that follows should also be seen as compensating a business for the provision of new and useful technology IP. Even once the user base and user data exist or are acquired, monetization is not possible without a robust platform and analytical tools which are again based on critical technological IP.

Materiality thresholds and exclusions (e.g. de minimis rules) are essential and have to be devised based on the new allocation key chosen for the proportion of non-routine profits to be re-allocated to the user/market jurisdiction. This is of special importance since new nexus rules would be devised such that the user jurisdictions would have the right to tax the additional profit allocable to them. Thus, without reasonable materiality thresholds an MNE could become a taxpayer in countries with only very limited local income allocated. This would substantially increase the administrative burden, uncertainty and controversy without a meaningful change in income allocation.

In new businesses and in particular in the digital arena, start-up losses are common and often last for many years, so the allocation and the carry forward mechanics are as important as the allocation of income issues. Even if the new allocation rules are restricted to large MNEs, in times of economic crisis losses might be significant. Countries would need to be willing to accept that depending on the allocation key the existence of sales, revenues, user or expenditures alone could lead to the allocation of considerable losses.

4. *What could be the best approaches to reduce complexity, ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes?*

   The scope for any application of the new approach should be limited to countries with mandatory arbitration in order to reduce the risk of double taxation.

   In addition, a fast track dispute resolution (for example, a simplified taxable profit adjustment mechanism for profit allocable to marketing intangibles) seems to be an inevitable step to undertake, as some countries would lose right to tax and some countries would gain appetite to tax, which would inevitably result in double taxation.

   Also, it should be clearly defined which entity is the taxable person that will provide relief from double taxation.

Global anti-base erosion proposal

Questions for public comments (section 3.6, page 29)

1. *What is your general view on this proposal? In answering this question please consider the objectives, policy rationales, and economic and behavioural implications of the proposal.*

   The 2018 Interim Report recognized that even as many of the BEPS measures have only very recently been implemented, the BEPS project already shows significant impact. As a response to Actions 8-10 MNEs realigned certain tax arrangements with real economic activity and further also changed distribution models. Besides the BEPS project also the recent US tax reform has exerted important adjustments. In our view, a new initiative would bring an additional dimension to the already very complex ongoing changes in the international tax framework.

   One could therefore question why new rules would again destabilize the global tax environment without a sufficient global impact analysis of the BEPS measures unless these are already seen as a total failure. Curing ‘remaining BEPS challenges raised by some countries’ does not seem a sufficient reason to totally destabilise the international tax principles. One could argue that visibility and stability of the international tax environment is to the benefit of more players, taxpayers and Member states included, than again drastically changing the rules to tackle ‘some’ concerns. Instead we would recommend to the OECD to continue the work on improvement of BEPS guidelines and execution including an in-depth analysis of the final impact of BEPS.

   This proposal seems to totally negate the territoriality principle and if so, it would be more understandable to go to a global formulary approach across all territories instead of negating the territorial approach and thereby not only opening the route to double or more taxation and negating the sovereignty of nations to set domestic tax rate and rules or incentives. We trust that this will result in a step back in ruling practices from published rulings affecting the base of taxation to more non-transparent special regimes outside the tax area (such as cash grants for special projects) that would affect fair competition; especially in countries where such alternatives do not exist (e.g. the European Union).

2. *What would be the most important design considerations in developing an inclusion rule and a tax on base eroding payments? In your response please comment separately on the undertaxed payments and subject to tax proposals and also cover practical, administrative and compliance issues.*

   For the income inclusion rule as well as the tax on base eroding payments the most important design consideration seems to be how the minimum rate should be determined and the mechanism for determining whether a corporation has been subject to tax at the minimum rate (i.e. the design of the effective tax rate test).

   Regarding the setting of the minimum tax rate this should be a uniform rate over all jurisdictions. A relative measure (e.g. 40% of the headline tax rate of the jurisdiction applying these rules) different for every jurisdiction would be extremely hard to administer. Also, such a relative measure would potentially create ripple effects, such that changes in tax rate in a certain jurisdiction could potentially affect the taxation in many other jurisdictions around the world.

   With respect to the effective tax rate test we have considerable concerns regarding the operation of such a regime. What would be the appropriate tax base for the determination of the effective rate? How were it to be determined? How would different tax rates, different definitions of the tax base, including tax rebates in different jurisdictions be combined to determine a coherently determined effective rate?

   According to paragraph 96 existing CFC rules would continue alongside any new income inclusion rule. However, as part of the recent US tax reform GILTI was introduced to operate as a minimum tax of 13.125%, such that taxpayers with a higher effective tax rate (ETR) would be outside its scope. However, the complexity of the new rules (in particular the computation requirements of the foreign tax credit pooling calculations) and their interaction with the existing CFC rules in the USA have resulted in a complex regime that does not operate as a pure minimum tax (i.e., taxpayers with ETRs of more than 13.125% are finding in practice that they have residual GILTI liabilities). We recommend detailed work be conducted by the OECD into ensuring this does not happen in relation to the income inclusion rule. A better result could be obtained through the bolstering of already existing CFC rules.

3. *What, if any, scope limitations should be considered in connection with the proposal set out above?*

   According to the consultation document the proposals are 'intended to respect the sovereign right of each jurisdiction to set its own tax rates, but reinforces tax sovereignty of all countries to "tax back" profits where other countries have not sufficiently exercised their primary taxing rights'. In our understanding there is a contradiction in this statement. There can be no sufficient or insufficient exercising of a primary taxing right. If profits are allocated based on an agreed international tax framework and where there is substance, the taxing rights fall to the allocated state which has the right to tax at a rate deemed appropriate. A deviation of these rules would overturn the territoriality principle and thus indeed supress the sovereign right of each jurisdiction to tax income with an origin within its own borders.

   Any income inclusion should be limited to those types of income subject to controlled foreign company rules. It is hence very important to take into account an active business test in this proposal. We believe that inclusion of such a test would avoid inappropriate inclusion of income, which is genuinely generated by true and value adding substance and activities in a low or no tax jurisdiction.

Lastly, if this is further investigated, nations should drop their existing CFC regulations as superposition of these two concepts would not make any sense.

4. *How would you suggest that the rules should best be co-ordinated?*

   We struggle in finding a way where the necessary consensus on sovereignty; minimum tax rate; territorial system; active business test; allocation and use of tax losses would be reached across the globe, unless a 'supra national legislation' immediately applies in all nations.

5. *What could be the best approaches to reduce complexity, ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes?*

   Consensus, supra national definition and mandatory fast track conflict resolution should be an integral part of the proposal. Questions shall also be raised in relation to the administration of the costs pertaining to taxation, audits and compliance in countries where a company has no presence at all.

Appendix 2: Specific comments on the content of the public consultation document

1. Introduction

1.1 The interim Report

There were a number of reports issued by the OECD recently (2017 and 2018) which draw conclusions on the effects of the BEPS project on the digital economy and recognize that actions 7, 8-10 and other anti-avoidance guidelines and legislation had a significant impact on the allocation of income for such businesses. The consultation document acknowledges that multinational enterprises realigned their tax arrangements with real economic activity and several highly digitalised MNE groups changed their distribution models. One could therefore question why new rules would again destabilize the global tax environment without a sufficient global impact analysis of the BEPS measures other than curing 'remaining BEPS challenges' raised by some countries.

One could argue that visibility and stability of the international tax environment is to the benefit of more players, taxpayers and member states included, than drastically changing the rules to tackle 'some' concerns. This does not exclude continuous improvement work on BEPS guidelines and execution, the full effect of which has not yet been seen given the ongoing implementation of the output of the project.

1.2 The New Phase of Work

One could also argue that that while curing remaining BEPS challenges can be part of a continuous improvement work handled by the OECD, which is well placed to do so, switching from such objective to the potential implementation of a totally new set of profit allocation and nexus rules is surprising. Both objectives are deriving from the need expressed by some countries to continue working on the digital economy challenge but the outcome that both can have on income allocation are very different and not at all correlated. Indeed, the application of new profit allocation and nexus rules is disconnected from any 'BEPS' issue, it is in fact a renegotiation of the distribution of taxation rights among countries and shall not bear the 'BEPS' label.

More importantly and very concerning to the business community is the section 3 of the paper which addresses 'broader tax challenges' and which is totally independent from the digital economy issue and somehow setting the scene for non-territorial approaches or new CFC rules and which reinforces to the public the message that all MNEs are using digital means to escape taxation, which is a very inappropriate message.

Given the significant potential impact of the proposals and in particular the move away from the widely-accepted arm's length principle, we consider that Section 3 if pursued further, should be dealt with in a separate paper and not embedded in the digital economy debate.

2. Revised profit allocation and nexus rules

2.1 Illustration of the challenge to the profit allocation and nexus rules

We disagree with the assertion in **Paragraph 11** that all three proposals within this section have the "same over-arching objective, which is to recognise…. value created by a business's activity or participation in user/market jurisdictions". While all three proposals clearly envisage an allocation of taxing rights to different jurisdictions than under the current model, the proposal in relation to significant economic presence has a very different objective to the other two proposals. It aims to determine a nexus from a broader range of circumstances, thus promoting the role of additional taxation in the source state, rather than responding to the perceived issues of arising from the digitalisation of the economy and concerns around intangibles. As such, we do not consider that it is possible for significant economic presence proposal to be combined with either of the other two proposals under discussion.

In addition, the reference to the recognition of 'value creation' as an overarching concept is somehow in contradiction with the statement expressed in the introduction that 'the BEPS project had significantly contributed to realigning income from intangibles with value creation, notably by putting greater emphasis on real economic activities (e.g. Action 5, Actions 8-10)'.

Paragraph 12 sets the scene and illustrates the issues that MNEs are facing with the user-based approach and the potential significant shift of income such approach may lead to.

For example:

Company A is incorporated in Country A and is the parent company of Subsidiary B located in Country B. Company A carries an R&D activity in Country A and has invested USD 10m in R&D, for developing a web-based platform to distribute its products in Country A and Country B. Under the current transfer pricing rules, one could expect that Country A will recover tax as Country B would earn a distributor margin and Country A would invoice royalties or retain a high margin on products sold to Country B. The value of users in Country B would be translated in higher sales, hence higher local distribution income to the benefit of Country B. This would probably be somehow acceptable to both Country A and B, although some countries may probably not be satisfied with a 'modest LRD return', but Countries where the R&D activities would be expensed would expect the vast majority of the income being allocated to them.

If Company A was incorporated in Country A but had no Subsidiary located in Country B and Company A would still carry an R&D activity in Country A and invested USD 10m in R&D, for developing a web-based platform to distribute its products in Country A and Country B, then without a physical presence nor permanent establishment in Country B, Company A would not pay corporate income tax in Country B (but would pay VAT or indirect taxes in Country B). The fact that Company A does not pay any corporate income tax in Country B is somehow consistent with the fact that Company A has established no infrastructure, nor base, nor invested in Country B. This would however probably be not acceptable to Country B.

If rules based on Marketing intangibles are adopted, then one could argue that Company A has created a marketing intangible in Country B, and that some income deriving from the location of the intangible asset in Country B should lead to taxation of some income in Country B even with no physical presence: Say Country B is way larger than Country A in terms of users and sales (say 80/20), how would this impact the value of the marketing intangible split and the amortisation of R&D investment in Country A? Say Country B sales growth is 3 times Country A sales growth, how would this impact the value of the marketing intangible split long term?

If rules based on a nexus approach based on users participation concept are established and there are no users nor sales in Country A, would that mean that the R&D activity should run at cost plus, and that all residual profit should be allocated to Country B? Does it really reflect the actual value chain of the underlying business to allocate a routine profit to innovation and a significant income to distribution?

All methods could be seen as valid methods in theory, but have very different impacts on Member States, as by definition the user participation and the marketing intangible methods will favour fast growing countries with a large user base vs. small user base countries with stable or declining economy.

One could then question how such countries would react in order to ensure the proper financing of the state. For example, one may argue that, these countries would be ultimately much more dependent on individual tax payers, thereby shifting the tax burden of such countries from MNEs to individuals.

Paragraph 13 boldly states that MNE groups “may seek to sidestep the nexus issue by establishing local affiliates which are not entitled to an appropriate share of the group’s profit” under the current model based on DEMPE functions and associated risks. We note that function analysis based on DEMPE functions is still a relatively new area in transfer pricing which is still being adopted across the business community. This means we have not seen the full impact of the changes in taxation post BEPS in the tax profiles of international businesses.

More importantly, based on the description of the proposed new profit allocation and nexus rules one could infer that DEMPE functions are way more accurately in alignment with value creation since the new rules necessarily depend on extremely generic assumptions about the value created by users or the value of marketing intangibles.

Furthermore, the general criticism in paragraph 13 about the pricing and profit allocation of Low Risk Distributors (LRD) seems relatively extreme. Based on a proper functional analysis, the profit allocation is benchmarked, taking into account many factors (and not solely a DEMPE analysis in determining entity profit). Where other taxation principles are pursued for intragroup distributors, there is a risk that there would distortions in the market, with independent third party and internal distributors deriving different profit levels.

Paragraph 14 opens the scope of the potential new rules to all businesses. This raises the question of over-engineering segmentation of traditional businesses that would inevitably have some highly digital functions.

2.2 Overview and background

2.2.1 The “user participation proposal”

Paragraph 17 states that is the proposal focuses on the value created by certain highly digitalised businesses through developing an active and engaged user base. However, we disagree with the assertion that only highly digitalised businesses have an active and engaged user base, such that the scope would not be as limited as anticipated. For example, when using definitions relating to users interactions, care would need to be given to ensure a user of an online log-in or portal for services such as post tracking or banking are not brought into the scope.

We also note that “business” does not translate into a specific tax or legal concept. Therefore, clarification is needed whether the objective of this proposal is to tax highly digitalised company groups or any business “segment” of any companies operating activities within the proposed definitions. Some of these business segments may only be side activities which do not contribute significantly to the net income of a company.

Paragraph 18 states that ‘This proposal is premised on the idea that soliciting the sustained engagement and active participation of users is a critical component of value creation for certain highly digitalised businesses. The activities and participation of these users contribute to the creation of the brand, the generation of valuable data, and the development of a critical mass of users which helps to establish market power’. While we can agree that the active participation of users may in some cases add value to the business, it is difficult to sustain that using a web-based platform as a pure alternative distribution channel vs more traditional channels is a critical component of value creation.

Further, where companies achieve a ‘sustained engagement and active participation’ they must incentivise users to do so in some way, e.g. by providing a useful service or experience to the user. Soliciting user participation thus requires the provision of services, cultivation of an active user base, intensive monitoring of user data, building and encouraging users to build a network. Such soliciting activities require significant capital expenditures as well as a highly qualified human resources (software engineers, data analyst, data scientist, web designer, game designer, product developer, product manager, systems engineers, etc.). These functions are critical activities of such a company and the success in soliciting user participation determines whether a business will be profitable or not. Hence these soliciting activities must be recognized as value creation by the company itself and an appropriate share of any value created by users should be allocated to the location of these solicitation activities which are the necessary precondition for any user participation.

Similarly, where in some cases participation of users could contribute to enhance the *value* of a brand, it is doubtful that it could *contribute* to the *creation* of the brand. If so, one should then accept that not only brand related income deriving from user participation should be allocated throughout the world, but also brand ownership, if user participation contributes to its *creation*. In this regard, if a Company now fully owning a brand from a DEMPE functional analysis standpoint, is now seen as co-owning the said brand in the future because of user participation throughout the world, what would, for example, be the impact if such company would sell one of its web-based platforms? Would it have to ‘buy-back’ its own brand?

While we realise that the definitions within **Paragraph 19** are intended to be only indicative at this stage, it already highlights that ring-fencing the business models within the scope of a “user participation proposal” would be incredibly difficult, particularly as nearly all businesses are increasingly digitalising and changing customer/user interaction as a result of advances in technology. For example:

- paid-for advertising targeted at users could cover both basic targeted advertising (e.g. a tennis federation with a user portal with an advert for a paid-for tennis clothing brand on its website, as through limited analysis it is obvious that most people who access a tennis website are likely to be interested in sports) to advanced targeting advertising (e.g. on social network sites where adverts for products viewed in the same internet browser by the user show up again as specific adverts for that user) as well as various levels in between.
- Another example is for search engines who do extensive monitoring of user data to allow them to tailor experience for the user. How does this vary from a supermarket collecting information on a shopper’s purchases via a loyalty card in order to send them vouchers for products they would be interested in? The scope is clearly not limited to highly digitalised businesses alone.
- A further example relates to business to business activity, such as if one non-retail company developed an app to attract customers, driving an increase in both sales for the non-retail company and for the company making the sale off the app, would this result in an increase in scope?

Paragraph 20 makes it clear that value is generated from user participation. Firstly, this assumes that there is always exploitation of user participation in order to generate other revenue or profit. This is not necessarily true, as mere collection of data (which is often automatic with the technology in existence) which is not accessed, analysed or acted upon in any other way for example due to bad data quality or regulatory reasons does not lead to value creation for a business.

Also, the negative aspects of user participation and contribution to brand must be considered. The actions of individual users can lead to issues for businesses as well as opportunities, for example, posting of inappropriate content online leading to damage to a social media site or sale of criminal goods. In this way, user participation must now also be heavily controlled to manage these risks. Any proposal recommended must be mindful of this additional layer of complexity and risk for businesses who do have user participation.

Furthermore, where there is positive (or negative) value attached to a user, this is likely to vary by country. Any proposal needs to take into account the variation in user location and its impact on deriving value for a business, as well as the level of engagement. Is an infrequent user in the UK more or less valuable than an in frequent user in Switzerland? And would this be affected by the frequency of the interaction with the highly digitalised business?

Paragraph 21 states that for businesses which have more traditional relationships with customers, the rules would not be changed. However, in a fast-changing environment, one can wonder what 'traditional relationships can mean. Indeed, if we rely on the definition of users' role in online marketplace, in the way they regulate the quality of the products and services by offering public reviews, there is a question mark on what the fundamental difference is between traditional businesses and non-traditional businesses. For example:

Company A manufactures and sells confectionary goods in some countries through a fully owned subsidiary, in some countries exclusively through online marketplaces and in some countries through independent distributors (such as independent hypermarkets), what would be the difference in terms of regulating the quality of goods and services from users in the various locations? Does such added value provided by the users differ depending on the distribution channel? The users are equally able to comment and contribute on the quality and to give feedback in all cases, be in through the local distributors' website and social networks, the web platforms or the third-party platforms or websites: Does it mean that Company A shall allocate some income to countries where independent distributors exclusively sell their products or services? As there is no doubt that whatever the channel, Company A can benefit from an 'active and participatory' user base.

As the discussion moves into mechanics, **Paragraph 24** sets out the steps for the profit allocation for this approach, there is also an assertion that a calculation of the non-routine profit is a relatively simply step 1, after removing routine returns from the profits of the business. There is often already controversy over routine returns and whether these activities are a) routine and b) remunerated appropriately. However, this will continue to get more complex where there are activities considered "routine" for a business which relate to user participation in their business model, e.g. is a routine return given for services provided between two countries in relation to users control of data privacy in a third territory? Should the remuneration allocated for such services continue to be remunerated in the same way and with the same amount, or does this also require a change? A decrease in remuneration is likely to lead to discussion and potentially audit from the territory providing those services as well, despite the fact the activity could continue to be seen as "routine" by the business. If it is maintained, the participation of users may become an overly expensive cost for a business which cannot be supported in the current cost structure.

The allocation key for a non-routine residual profit split will also be central to the design of such measure, however, there is very little detail on this at the moment within **Paragraph 24**. For example, we note that revenue does not capture the economic reality for profit generation relating to a market as it is dependent on local market costs and competition profile (amongst other factors).

With no doubt the determination of the allocation key would be central to the process (as in the first step when defining a residual profit to split, many would say that it is not very different from the current arm's length profit split approach). This is what has refrained Europe from implementing the CCCTB for many years and it is doubtful that all countries would be aligned on what key to use, although crucial to the set up as if all countries where not to be aligned, then MNEs could suffer not only double for multiple taxations of the same income. We also note that without Advanced Pricing Agreements (or some other form of agreement) companies would face significant uncertainty in relation to their tax position. However, conclusion of such APAs would be extremely lengthy and costly, for both the taxpayer and the tax authorities.

Paragraph 27 raises a very important issue on dispute resolution: Currently when MAPs take place, they tend to resolve the issues in relation to past years and not the future as they are deriving from compromises and not TP methods. Not only MAPs would need to be fluid and strengthened but they will also need to be based on technical merits rather than negotiations without technical base. We also emphasise again that a strong dispute resolution component is seen as critical for business to support any proposal and should not be seen as an optional add-on to any solution proposed.

Paragraph 28 reiterates the intent for such a proposal to be targeted and how it would “perhaps be limited” to certain highly digitalised businesses, including potentially to include a range of additional restriction based on the size of the business. It is logical to take into account additional restrictions based on size of the business, but it is also complicated to determine the “additional restrictions”. Will these be on a per country basis for example or just to determine which companies have to do this type of calculation (meaning a lot of potentially very small allocations of profits to some jurisdictions)? What about where user base is spread across multiple entities, will this be aggregated? The number of exceptions and the complexity of actually defining high digitalised business activities makes this approach very difficult to agree upon internationally and there is likely to be differences in how countries define the activities and additional restrictions within domestic law, for example, small countries will have less desire to restrict based on pure number of users.

Additional note: The paper is silent on allocation of tax losses, but in new businesses and in particular in the digital arena, start-up losses are common and often last for several years, so the allocation and the carry forward mechanics are as important as the allocation of income issues.

Further additional note: details of calculation of profits (and losses) are not discussed within this paper. We note that the calculation of profit varies under different accounting standards, such that a common approach would need to be decided upon. One suggestion is to work with the accounting standards applied for preparation of a group’s accounts, although we note this may not be applicable for small groups who are not required to prepare consolidated financial statements (and currently no thresholds are included within the proposals for discussion). Some businesses also note that in practice, the use of accounting standards (e.g., IFRS) to setup transfer prices is challenged in some countries by local tax inspectors favouring local accounting standards. Therefore, a strong commitment from countries on accounting standards for such profit calculation is required to limit further uncertainties and double taxation.

2.2.2 The “marketing intangibles” proposal

Paragraph 31 describes how a functional link is envisaged between marketing intangibles, such as: (a) brand and trade name; and (b) other marketing intangibles such as customer data and lists; and the local market. It is stated that some marketing intangibles, such as brand and trade names, are ‘reflected in the favourable attitudes in the minds of customers and so can be seen to have been created in the market jurisdiction’. This point is reiterated in paragraph 33. The perception of a brand often cannot be considered on an isolated domestic level – for example, if a brand is popular in the US, it may lead to knock on popularity in other countries. Further, the consultation document recognizes that digitalisation and lower communication costs have increased the opportunities for a modern enterprise to reach and interact with customers in a given market remotely. Thus, while the value created in terms of marketing intangible may have an intrinsic functional link to the market jurisdiction, the actions of a business necessary in order to create this value can and increasingly do take place remotely. In paragraph 33 it is recognized that marketing intangibles like ‘favourable attitudes in the minds of customers’ and costumer information and data are the result of an ‘active intervention’ of businesses. Thus, a functional analysis should allocate at least part of the value created in the form of such marketing intangibles to the jurisdiction from where the relevant employees operate. Furthermore, brands can be negatively perceived by customers due to other events. How could such a scenario be captured in the marketing intangible approach? We also note that positive, negative and indifferent attitudes in local markets are difficult to define and even more difficult to measure.

Paragraph 32 reiterates the intention to give market jurisdictions the right to tax highly digitalised businesses (and other businesses under this approach) even in the absence of a taxable presence. Taxation without taxable presence is a complex environment and is likely to lead to disputes. If marketing intangibles are seen as a local asset, they should be treated as such and therefore lead to the existence of taxable presence.

Paragraph 32 also states that the proposal is to require both the marketing intangibles and the risks associated with such intangibles to be allocated to the market jurisdiction. Normally control of the risk is rewarded under current transfer pricing principles. A functional analysis should still be performed in relation to these transactions to assess which entity or company) really bears the risk. For example, it would be inappropriate for risks relating to brand management to be passed to a local entity with a reward if there is substantial work done on this topic by other entities in the group.

Paragraph 33 raises the same issues than the user participation: does the distribution channel of a traditional business really influence the location of its marketing intangibles? In addition, how do you allocate the marketing intangible in a highly fragmented market? In a BtoB business?

For example, Company A sells beverages to distributors (independent hypermarkets) in all countries. Company B (third party) develops an app which is aimed at sending a text to consumers of products of Company A when they cross the street close to a hypermarket running a promotion on such products. Consumers are not clients of Company A but clients of the hypermarket. Consumers data are owned by the hypermarkets but are managed by Company C (third party to all), to which the hypermarket has subcontracted the analysis of the data. Where is value created and by whom if value creation is based on data and consumers feedback? Would the allocation be different if all players where part of the same group but in different locations?

Paragraph 34 states that the intrinsic functional link to a market jurisdiction leads to an inherent difference between marketing and trade intangibles. However, the perception of a brand often cannot be considered in on an isolated domestic level – for example, if a brand is popular in the US, it may lead to knock on popularity in many other countries for example through the export of cultural goods such as movies or music. Similarly, a common language and as a result a shared cultural area reflected in shared TV-stations, Newspapers, Theatre and Books may lead to significant cross-border effects of marketing intangibles. Favourable or also unfavourable attitudes in the minds of customers regarding certain products in Germany may knock on fast to the German speaking part of Switzerland, attitudes from France to the French speaking part and from Italy to the Italian speaking part.

Paragraph 36 is right in stating that the marketing intangible method is closer to the current definitions and principles and only tries to take into account an additional asset that was not isolated in some TP methodologies before. However, practical issues such as the determination of allocation key (revenues, data, users, …) will be also critical to the success of this method and one aspect that one shall not neglect is that as opposed to a pure nexus user base allocation, the valuation of the intangible would probably lead to more controversies and multiple taxations for MNEs.

Moreover, we note that best practice benchmarking studies reflect marketing intangibles or equivalent status within a group, such that the benchmark should be already providing sufficient information (i.e. the marketing intangible does not need to be considered as a separate asset to be isolated). Where this is not sufficient, we consider an alternative approach could be to provide additional guidance on application of a DEMPE analysis to marketing intangibles with examples to provide clarity on application to such assets.

Paragraph 38 raises a question on how important the source of customers or consumers knowledge is (on line sale platform or physical shop). Is a business really in a better position to collect data and insider's knowledge because of the distribution channel it uses in a given territory or is it rather related to the local size of the business (the more market share, the more data you would collect). For example, in a very new business on line (optical, pharmaceutical) do you really get a competitive advantage by running web platforms in a highly digitalised environment vs. long-time players operating from traditional shops? When is the digitalization of the business going to be considered strong enough, efficient enough so that a marketing intangible would be recognized? To foster equity, coherence, and a level playing field would it not be necessary to expand the concept and also recognize a marketing intangible for the more traditional international businesses, as soon as they collect data at shop level? For example, is collecting data from a customer in a retail store to further send emails during sales constitutive of a marketing intangible?

Paragraph 39 raises a critical issue about the fair return on investment for the entity within the MNEs organisation which takes risks and runs innovation. Where data are of essence to improve a business, they often do not participate nor initiate the creation of a concept, idea and ultimately an intangible. Therefore, one could ask if the allocation of marketing intangibles across the territories does not carry a timing aspect, e.g., would the intangible carry value cross border the year a service or a product is launched, or rather later once the value of the intangible is sustained by local growth cross border?

The impact of the marketing intangibles proposal on the three business models, as set out in **Paragraphs 40 to 42** demonstrate the breadth of scope. As more and more businesses are becoming “highly digitalised”, we consider that a broader approach which applies to all is likely to be more workable than the user participation approach, which would require constant amendment on the side of tax authorities to reflect ongoing digitalisation and lead to intense monitoring for businesses to assess whether they have come within the scope for each period. That said, Paragraphs 40 to 42 also show the potential scale of the changes which could arise for all businesses as a result of these proposals.

We also draw attention to the **footnote for Paragraph 40** which states that highly digitalised businesses will often have invested in community and wider brand positioning so as to enhance their subjective appreciation by their users. This is not a strategy pursued by highly digitalised businesses alone and is very far removed from the creation of measurable profit. Therefore, if this proposal wishes to focus on conceptualising the acquisition of customer/user data and taxation of any profit derived from monetisation this, there still must be a link to at least show that profit (or loss) has been derived based on the marketing intangible, and not simply other business promotion activities. Further, the footnote states that highly digitalised businesses often acquire customer data in exchange for free services. The provision of these services is recognized as an investment in a marketing intangible. Hence, if such costumer data/marketing intangibles are monetised at least part of the profits should be allocated to the jurisdiction which has beard the cost and the risk of this investment and where the products and services in order to acquire costumer data have been developed, produced and provided. While such customer data has an intrinsic functional link to the market jurisdiction, the business activities necessary to acquire them have a very strong intrinsic functional link to the residence jurisdiction.

Paragraph 43 states that the non-routine income of the MNE group attributable to marketing intangible should be allocated to the market jurisdiction. It is very important that marketing intangible are well defined and valued and that specific marketing intangible are isolated before this step is undertaken: For example, in a franchisor/franchisee relationship, the franchisor usually develops branding advertising material globally and the franchisee undertakes local trade marketing actions. Shall the two marketing intangibles be added up and then shall the related income be allocated back to the market jurisdictions? As one could argue that both contribute to the value of the brand and the market share globally and are constitutive of non-routine profit. Shall both be isolated and how shall they then be valued and allocated? Is this the end of a net sales-based royalty set up for brands in a franchisor/franchisee relationship?

According to **Paragraph 44** the allocation of the non-routine returns from marketing intangibles would be fully independent from any activities executed, functions assumed and risk beard by the MNEs. Such an allocation would be correct if marketing intangibles were generated by users themselves spontaneously without any contribution by business. This seems at odds with economic reality, however. Marketing intangibles result much more from an interaction between businesses and costumers. And the success of businesses attempts to create such marketing intangibles are a crucial factor that determines their profitability mark-up relative to routine returns.

It is very critical that a definition of ‘routine marketing functions’ is provided by the OECD to avoid multiple conflicts in allocating the routine income to such routine functions as **Paragraph 44** is describing. A new product development could indeed qualify as routine or non-routine (e.g., a new flavour in a branded product, a more solid product in heavy industries, a new feature in the beauty industry, a perfume line in the luxury sector, etc….). If it is easy to define what functions are routine in the overall value chain (manufacturing, logistics, procurement, marketing, sales …), it is not easy within a function.

Where the local market presence is currently a distributor, further guidance on the calculation of routine returns would be also welcomed. Indeed, it would be important to make sure that the margin for the distributor does not already include a return relating to a marketing intangible. For instance, selected comparables used for the benchmarking study may include such returns and an adjustment to comparable might be required and would add further complexities.

With regard to the mechanics of the proposal in **Paragraph 47 to 48**, many of the same points in relation to performing a non-routine residual profit split apply here as for the user participation approach (such as identification of routine return and allocation key). **Paragraph 47** also touches upon the calculation for the amount of non-routine profit to be attributable to marketing intangibles, e.g. a cost-based method vs more formulaic approaches. This is key to the design of the proposal and will determine the impact of the proposal for highly digitalised business models vs more traditional set-ups.

Furthermore, in relation to allocating such an amount to market jurisdiction in **Paragraph 48**, there is likely to be a timing impact on who feels “entitled” to the profits relating to marketing intangibles. For example, soon after development, it is likely that the marketing intangibles (e.g. brand or customer lists for new markets) have a strong central base, however, as the business activity grows in local jurisdictions, should the profits shift away from the central IP hub, even if they are responsible for the continued enhancement, protection and maintenance of the IP?

Also, in more formulaic approaches, how would the allocation take into account the difference in the profitability in the different markets? In high prices/high market share countries should the apportionment be the same than for other less profitable countries?

2.3 Potential design considerations

2.3.1 Scope and potential limitations

As noted earlier in this document, we believe that a wider scope as is envisaged under the marketing intangibles approach is likely to lead to more consensus among the business community and to less administration than a (supposedly) narrowly-focused scope based on tight definitions for highly digitalised businesses.

We agree with work being done in relation to *de minimis* rules and other exemptions but can see a practical problem in getting all members of the IF to agree. In particular, countries with smaller GDP and/or smaller populations are likely to feel a lower threshold is justifiable in their territory to avoid the only advantages for this proposal falling to large economies with many individuals.

2.3.2 Business line segmentation

We note that many businesses do not have the systems in place to be able to accurately delineate all business lines in their system, including the revenue and costs. Furthermore, a decision needs to be taken at a policy level on the granularity of the proposals where digital activities currently contribute to side businesses. For example, should the percentage of the non-routine profit to be allocated across jurisdictions be lower if this is a side-business compared to the main business?

2.3.3 Profit determination

There is a balance to be struck between simplification and still proposing a measure which resembles economic reality for how much profit can be attributed to marketing intangibles or user participation. As noted earlier in the document, we can foresee a scenario where calculation of routine profits must also be amended to take into account the fact that income (and cost) will be allocated to local territories. One recommendation could be to review the safe harbours applied within transfer pricing guidelines (e.g. for low value adding services) or to try and reach some international agreement on their acceptance.

Where there is a combined profit of multiple entities approach, it should be noted that most multinational groups split functions across territories, so the logical multi-entity groups are likely to still be cross border and therefore need a further method for determining the country level profit.

2.3.4 Profit allocation

The allocation key for the split of profit between territories is also crucial to the design of the proposal taken forward. Taking the proposed allocation keys in turn:

- Sales or revenues – these do not recognise any costs and therefore do not represent the economic reality of business within a country; moreover the numbers would need to be adjusted for purchasing power, as a business with highly successful activity in a country where prices are generally lower should not allocate more profit to a country with bad sales but where each sale generates a large chunk of revenue.
- Users – users is an incredibly complex value key to measure. Where entities do have some knowledge of the number of users they have, there are still questions around double counting (e.g. users with multiple devices), location of users (e.g. when they are travelling) and level of active participation.
- Expenditures in particular jurisdiction, e.g. marketing spend – spend does not necessarily equate to success, for example, extra spend may be required following a scandal affecting brand image, but it may not be successful in changing the opinions of the consumer. Furthermore, spend across countries varies wildly based on the local economy and the type of advertising or marketing desired in that market. Sometimes spend in one territory also has a

knock-on effect in another territory or marketing may be done on a global campaign level, e.g. redesign of a company brand is likely to be led by a centralised unit but impact all local markets.

It is therefore clear that allocation key remains an important point for consideration and it is likely that the final proposal will need to provide options to business based on the information available to them and what that company considers to be a broadly accurate allocation key in their industry.

If such a new allocation method should be introduced, it is important to introduce a transition rule that allows for a systematically correct shift out of the previous system. The new allocation method would mean that the IP created in the producer location under the current allocation regime is shifted to the consumer location, similar to the actual move of business functions. As a consequence, the production country is entitled to levy an exit taxation for the transferred intangible (net present value of profits taxed in the consumer location going forward, the producing country may spread the respective income recognition over certain period of time); and the taxpayer is entitled to do a step up in the consumer location, which may then tax effectively be written off.

2.3.5 Elimination of double taxation

International agreement at this stage is a vital first step to ensuring that double taxation is minimised as a result of any new proposal arising from this project. Where international consensus is not reached, there is no doubt that there will be significant double taxation, including that certain countries who are introducing other taxes relating to digital activities (including the UK, France and Spain) will not cease implementation of the other taxes, largely due to political reasons.

We also note that while the Inclusive Framework has brought many countries to the table for discussion on this topic, there remain countries which are not involved and who favour their own TP methods. Similarly, some of the countries involved are still not full OECD members. This adds complexity in ensuring one common approach, in particular for defining routine returns. It is therefore important to have consensus by non-OECD countries on recognition of OECD transfer pricing guidelines to reduce incidents of double taxation.

Even if an international agreement is reached, as we potentially are moving away from relatively well-established profit allocation principles, there is likely to be a proliferation of bilateral discussions and negotiations that the current dispute mechanisms are ill-equipped to deal with even after important recent initiatives and improvements. It is therefore essential that work is done on developing a faster and comprehensive method of dispute resolution, which should be included from the outset in an upcoming agreement. The dispute resolution mechanism should facilitate the involvement of several countries (including countries without tax treaties). There must be commitment internationally to strong dispute prevention and resolution components and a commitment to a timeframe for enquiry and resolution. Mandatory binding arbitration would substantially reduce taxpayer uncertainty and therefore promote investments. This is very important for businesses, in particular to ensure they are not discouraged from technological advances and increased digitalisation due to tax compliance risks and the likelihood of complex audit and litigation.

2.3.6 Nexus and treaty considerations

The proposals require a new nexus in order to allow for taxation of the profit allocated by territory.

A new nexus concept based on user participation, marketing intangible or significant economic presence will also make some businesses taxable in jurisdictions they have not taken decisions to operate in. It is often a strategic business decision to enter a market or to be active in a jurisdiction. With the proposals, businesses could lose control of which jurisdictions they are taxable in. This may also apply if residual profit accruing to marketing intangibles is allocated to a market jurisdiction based on sales.

It should also be considered whether the treaty network is sufficient to provide comfort to businesses. While many countries such as Switzerland have a strong treaty network in place, there are still many territories where profit may be allocated under the new proposals and countries do not have a treaty between them. Furthermore, what would be the correct treaty to consider? These points should be kept in mind when deciding how to design the proposal and deciding on the scale of the proposal.

2.3.7 Administration

We appreciate comments on administrative considerations as the administrative burden of a new proposal is also important for businesses. This includes monitoring the implementation and thresholds for the proposal, filing obligations where entities are (and are not) required to pay tax and also payment and collection mechanisms. With regards to thresholds, some ideas raised amongst business include:

a. **Size/materiality:** the new principles could only apply for large MNEs, given the potential heavy and complex burden on SMEs. For example, the CBCR threshold could serve as a threshold to limit the impact for mid-sized companies and start-up companies, who are vital to maintenance of a healthy economy.

b. Losses: The treatment of losses needs to be clarified, including start-up losses.

c. Profit level: A safe-harbor for the mark-up and/or distribution margin could be considered. This could also be pursued as an interim measure while the larger changes with significant impact are fully worked through.

Early certainty is important for businesses, whether provided through detailed guidance which is accepted by tax authorities or other processes, for example those being trialled under ICAP.

Paragraph 85 of the consultation document contains a reference to the CbCR for additional data collection in case a profit split is to be applied. The purpose of the CbCR is to provide the participating tax administration with a sound basis for risk assessment activities and not tax assessment. Already today, preparing the CbCR is a huge additional effort for taxpayers.

As this is a profit allocation with taxing rights likely to result in corporate income tax burdens, consideration should be given to whether a simplified filing may be possible when this is the only profit arising within a territory, as well as a shorter statute of limitations.

A withholding tax mechanism, while sounding simple, is administratively burdensome to operate and often has cash flow implications. Furthermore, this is not appropriate where there are no transactions involving cash payments as withholding will need to be elsewhere within the group to reflect tax payable in a different country.

2.4 Questions for public comment

Please see Appendix 1.

3. Global anti-base erosion proposal

We first want to reiterate our comment that we do not understand why this section is included in the document aimed at analysis the impact of digitalisation of the economy and why this proposal is even open for public consultation where BEPS results and analysis is not even available at this stage. We consider that this is fundamentally a new global proposal and should be discussed separately.

3.1 Overview and background

3.2 Mechanics

We are surprised that the OECD brings to the table an approach which negates the foundation of the BEPS work which is not allocate income and ensure taxation where value is created and favour the country of incorporation of a multinational and even would discourage such multinational to expand its business across its territory.

Where we understand, accept and apply CFC rules, this proposal which negates active substance at subsidiaries level and sovereignty of other territories in defining their own tax rules, goes far beyond a CFC principle. It also goes far beyond the anti-hybrid or interest limitation rules (which could be seen as CFC regulations beyond a parent company/subsidiary relationship), as it would negate international sound rules to avoid double economic taxation; which are totally unrelated to tax evasion, tax avoidance or even tax optimisation (e.g., exemption of dividends through participation exemption could lead to the application of global anti-base erosion approach as drafted in the document for consultation).

There are also concepts that are not clearly defined in the document, where we believe that the more stringent the rules are, the clearer they should be to the benefit of all parties. For example **Paragraph 94** refers to ‘thickly capitalised’ entities, without defining what it refers to. **Paragraph 104** refers to ‘imported arrangements’.

3.3 Income inclusion rule

Paragraph 96 suggest the use of a 25% ownership test, which is not workable as there is no logic in applying anti-base erosion rules to a company that does not control a business nor may not have access to financial data and be able to understand the appropriate treatment of the transaction.

We believe that the rules cannot apply unless a taxpayer controls the company subject to the rules.

There are a lot of unanswered questions in the consultation document which are critical to appropriately comment the proposal, such as how would you define a minimum rate, would that be a uniform and consensual view, would tax credits be available, how to treat tax losses carried forward, what would be the required documentation to be provided in each country where a parent company is established, how do we couple the rules with the existing CFC rules, how are the rules not double counting other BEPS measures which are more of a transactional nature (such as anti-hybrid rules), …

3.4 Tax on base eroding payments

We refer to our general comments above and in our executive summary, especially regarding sovereignty, complexity of superposing tests at entity or at transactional level, international consensus and double taxation resolution.

We also are anxious to understand whether this proposal would force taxpayers to trace, identify and substantiate all transactions and/or payments they make on a day-to-day basis.

3.5 Rule coordination

There is no doubt that co-ordination of such rules would be incredibly complex. Also, there are likely to be differing preferences from countries between income inclusion rule vs taxes on base eroding payments based on the structure of their economy. We also consider that any additional tax would need to be limited to the potential new minimum tax rate and not the local rate.

To both the points above, a clear analysis of the issue needs to be prepared and agreed by all stakeholders against which the design of a measure can be reviewed.

3.6 Questions for public comment

Please see Appendix 1.