OPINION STATEMENT

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CFE Response to the OECD Consultation Document: Addressing the Tax Challenges of the Digitalising Economy

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CFE Tax Advisers Europe is the European umbrella association of tax advisers. Founded in 1959, CFE brings together 30 national tax institutes, associations and tax advisers' chambers from 24 European countries, representing more than 200,000 tax advisers. CFE is part of the EU Transparency Register no. 3543183647-05.

We would be pleased to answer any questions you may have concerning our Opinion Statement. For further information, please contact Stella Raventos- Calvo, Chair of the CFE Fiscal Committee or Aleksandar Ivanovski, Tax Policy Manager at info@taxadviserseurope.org. For further information regarding CFE Tax Advisers Europe please visit our web page http://www.taxadviserseurope.org/

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We are responding to the OECD public consultation of 13 February 2019, outlining proposals agreed by the members of the Inclusive Framework on review of the international tax rules arising from the tax challenges of the digitalising economy. The document sets out a two-pillar approach for concurrent review of the nexus and profit allocation rules as well as other policy solutions to address the 'tax rate' arbitrage and the remaining BEPS challenges. Of necessity, we are providing a high-level response due to the short consultation period and the current initial state of the proposals.

CFE strongly supports the aim of a future-proof, longer-term reform of the international tax system to address the tax challenges of the digitalisation of the economy. CFE understands the competing aims and objectives of different countries within the Inclusive Framework, but in absence of a common approach, we are increasingly facing an uncoordinated international tax landscape of unilateral actions being taken by individual countries. Such actions inevitably lead to less alignment of tax bases globally, resulting in double taxation and significant compliance burden for businesses, consequently stifling economic growth and innovation.

The OECD's proposition to encourage conclusion of multilateral APAs, provision of multilateral risk-assessment of taxpayers and joint tax inspections, will mitigate but not alleviate the complexity of the proposed methodologies and the related tax certainty concerns.

Given the pace of transformation of the global economy, proposed changes need to be ambitious and sustainable in the long-term, able to follow the rate of emergence of new business models. CFE encourages redoubling of efforts to achieve an early consensus among the Members of the Inclusive Framework on the way forward.

Pillar 1: Revised profit allocation and nexus rules

As acknowledged by the OECD, the underlying policy rationale of the proposals is aligning profits with the underlying economic activities and value creation.[1] CFE supports the proposal to focus on the economic link between the users/ market jurisdictions and the value created therewith. We believe that in arriving at a global solution, it is important that traditional concepts of international tax law are not forgotten in the process. The solution should remain consistent with the OECD's long-standing approach to the international tax framework that corporate tax is due where the underlying economic activity takes place and where the value is created. From CFE's perspective, these proposals appear to address these issues conceptually but are legally and technically very complex.

The proposals, as presented, envisage solutions that go beyond the Arm's Length Principle (ALP) by way of proposing novel methodologies of apportioning profits. These developments would represent a change of direction from the recent work through the BEPS project and the OECD Transfer Pricing Guidelines, hence diverting from the existing international tax framework, and in particular the ALP. In CFE's view, it will be immensely difficult in reality for tax administrations, taxpayers and tax advisers alike to work with the suggested methodologies on a multilateral basis.

In an attempt to allocate taxation rights to market jurisdictions by way of quantifying the user participation, it is significant to use metrics that represent an objective measurement of the value of the user participation in order to determine the profits attributable to it and how such profits should be divided between jurisdictions. In doing so, it should be possible to benchmark the proportion of the residual profit which relates to the user participation and the proportion which relates to intangible assets. We recognise the difficulties in defining the business models as current definitions are likely to become outdated in due course. Given the pace of change of the

[1] Para 5 of the OECD Consultation Document of 13 February 2019

digital environment, solutions need to be future-proof and consistent with the principle of aligning profit with underlying economic activities and value creation.

The 'marketing intangibles' model is wider in scope and not confined to purely digital business models. Hence, it could impact the wider world economy making it potentially more challenging to address the fundamental underlying issues. The impact on specific business models is not yet clear considering the initial stage of the proposal and it will depend on further technical detail. At its essence, the model advocates that more income is allocated from the jurisdiction of the entrepreneurial risk to the destination of the consumer. Whilst there is merit in adapting the arm's length principle to recognise that a portion of the residual profits could be allocated to a value-creating entity in the market jurisdiction, such value must be measurable and it must be possible to benchmark it. However, if the cost-based approach is considered[2] as a potential method of apportioning residual profits to marketing intangibles, it is important to consider that companies can frequently invest funds into new products or R&D. In addition, a common understanding of what amounts to residual profits should be preceded by a global agreement on what constitutes a profit of a business. CFE underlines the complexity of the transfer-pricing transactions and arriving at such figures under the present system.

Further, the administration of the marketing intangibles method would give rise to double taxation in multiple jurisdictions and will entail a significant compliance burden for businesses. In recognition of the disputes and double taxation that this proposal is likely to give rise to, the document calls for early certainty mechanisms for taxpayers. The proposal would also require significant treaty changes (or a new multilateral instrument) to avoid double or multiple taxation. Practically, it will be potentially difficult to separate the profits attributable to marketing intangibles from trade intangibles, as these are often intertwined.

The significant economic presence proposal is at its early stage of development but is likely to raise sovereignty issues comparable to those regarding the EU proposals on CCTB/ CCCTB. Similarly, there are EU law issues concerning the collection and enforcement mechanism via imposition of withholding tax. From an EU law perspective, the imposition of withholding tax by a Member State may be contrary to the EU fundamental freedoms if it exempts resident entities but applies to comparable non-resident entities in the same Member State.[3]

More generally, in relation to the apportionment methods advocated in these proposals, it emerges that a new international tax framework would be required to make these methods operational in a global setting: new legal instruments, guidance and widespread multijurisdictional consensus. Inevitably, the issue of double taxation would arise, which is already difficult to address considering the bilateral nature of double taxation treaties and inadequacy of tax dispute resolution mechanisms at present. For these reasons, CFE will refrain from endorsing any of the profit allocation proposals at this stage.

Pillar 2: Residual BEPS issues

The second pillar aims to resolve remaining BEPS issues and the 'rate arbitrage' by exploring two sets of interlocking rules, designed to give jurisdictions a remedy in cases where income is subject to no or very low taxation:

- **Income inclusion rule**, where income of a foreign (related) company would be included in the taxable base of the controlling one, provided the income was subject to no or very low taxation.

[2] Para 47 of the OECD Consultation Document

[3] Article 49 of the Treaty on the Functioning of the European Union and judgment of the Court of Justice of the European Union C-190/12 *Emerging Markets Series of DFA Investment Trust Company v Dyrektor Izby Skarbowej w Bydgoszczy*

- **A tax on base eroding payments (minimum tax rate),** that would deny treaty benefits if the beneficiary is not sufficiently taxed in the other jurisdiction.

From CFE's perspective, some time should be allowed to evaluate the full effect of the existing BEPS standards, some of which are still under implementation in most countries of the Inclusive Framework. Consequently, a longer-term perspective seems more appropriate to appreciate the entirety of the remaining BEPS issues. Similarly, within the EU a number of anti-BEPS policy and legislative measures have been introduced with the ATAD and ATAD2 directives, which significantly reduce the incentives to shift mobile tax bases to low-tax jurisdictions.[4] From an EU perspective, this is particularly the case where policy initiatives such as the EU list of non-cooperative jurisdiction for tax purposes or the introduction of CFC rules are designed to achieve the same objective as the income inclusion rule. In addition, the EU's objectives as set out with establishment of a list of non-cooperative jurisdictions for tax purposes are closely aligned with those of the BEPS project, which is to increase transparency and encourage compliance with anti-BEPS measures.

Further, there seems to be an overlap of the proposed global anti-base erosion proposals with the current work under Action 5 of the BEPS project relating to identification of preferential regimes. Indeed, the most recent progress report on preferential regimes also contains details of a new standard for substantial activity requirements within jurisdictions with no or low taxation, aiming to establishing a level playing field between the jurisdictions introducing substantial activity requirements in preferential regimes, with those offering low or no corporate tax.[5]

More generally, it is critical that the measures are targeted at profits arising in countries where there is no real or substantive activity carried on, in line with the aspirations of the BEPS project to pay tax where the value is created. In addition, *de minimis* threshold should be considered to prevent these rules from becoming a barrier to business development, innovation and new markets.[6] This is relevant in particular as the risk of increased profit shifting concerns large global companies of a particular size.

There are a number of EU law points that are raised with the income inclusion rule. Primary EU law (fundamental freedoms) requires EU Member States to refrain from imposition of additional taxes on the profits of an entity established in another Member State, unless the measures are limited in scope and target 'wholly artificial arrangements'.[7] Similarly, the tax on base eroding payments faces EU law challenges: denial of deduction by an EU Member State due to a lower tax rate in another Member State would be contrary to primary EU law (freedom of establishment and freedom to provide services in the Single Market). The proposals are likely to continue to put pressure on the existing transfer-pricing framework, and any disparity in the implementation of minimum tax rate proposals is inevitably going to lead to double taxation, in instances where countries fail to take into account tax already paid under such regimes (under CFC rules or under the GILTI regime in the United States). Finally, the outcomes of a global minimum tax rate will differ significantly depending on the chosen model: jurisdiction-by-jurisdiction approach (the OECD proposal at present on basis of the Franco-German paper) vs. an average rate approach (like GILTI). The complexities in designing a minimum tax rate in a global context will be technically challenging and, as such, will require efforts by the OECD and the Inclusive Framework jurisdictions to ensure close international coordination.

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[4] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market and Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

[5] OECD, *Harmful Tax Practices - 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (2019), paragraph 6

[6] The Base Erosion and Anti-Abuse Tax (BEAT) under the Tax Cuts and Jobs Act in the United States applies to companies that exceed the $500 million revenue threshold only

[7] Judgment of the Court of Justice of the European Union, Case C-196/04 *Cadbury Schweppes*, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue

In conclusion, CFE encourages redoubling of efforts to achieve an early consensus among the Members of the Inclusive Framework on the way forward regarding the revision of the profit allocation rules. Indeed, efforts to address the whole international tax framework, rather than the specific challenges related to the digital economy, would make it potentially more challenging to address the fundamental underlying issues. CFE expresses reservations concerning the proposed global minimum tax rate (income inclusion rule and global anti base erosion proposals).

About CFE Tax Advisers Europe

CFE Tax Advisers Europe is a Brussels-based umbrella association representing European tax advisers. Founded in 1959, CFE brings together 30 national organisations (tax institutes, associations and chambers of tax advisers) from 24 European countries. CFE's Member organisations are:

AT	Kammer der Steuerberater und Wirtschaftsprüfer (KSW)
BE	Institut des Experts-Comptables et des Conseils Fiscaux / Instituut van de Accountants en de Belastingconsulenten
CH	EXPERTsuisse
CZ	Komora daňových poradců ˇCR (KDPČR)
ES	Asociación Española de Asesores Fiscales (AEDAF)
	Registro de Economistas de Asesores Fiscales (REAF)
FI	Suomen Veroasiantuntijat ry (Association for Finnish Tax Professionals)
FR	Institut des Avocats Conseils Fiscaux (IACF)
IT	Associazione Nazionale Tributaristi Italiani (ANTI)
	Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili (CNDCEC)
IE	The Irish Tax Institute (ITI)
LU	Ordre des Experts-Comptables (OEC)
LV	Latvijas Nodoklu Konsultantu Asociacija
MT	Malta Institute of Taxation (MIT)
NL	Register Belastingadviseurs (RB)
	De Nederlandse Orde van Belastingadviseurs (NOB)
PT	Associação Portuguesa de Consultores Fiscais (APCF)
PL	Krajowa Izba Doradców Podatkowych (KIDP)
RO	Camera Consultanţilor Fiscali (CCF)
SM	Ordinei dei Dottori Commercialisti e degli Esperti Contabili (ODCEC)
SI	Zbornica Davcnih Svetovalcev Slovenije (ZDSS)
SK	Slovenská komora danových poradcov (SKDP)
UK	The Chartered Institute of Taxation (CIOT)
	Tax Faculty – Institute of Chartered Accountants in England and Wales (ICAEW)
UA	The Union of the Tax Advisers of Ukraine

Observers:

HR	Hrvatska Komora Poreznih Savjetnika (HKPS)
LT	Association of Lithuanian Tax Advisers
NL	De Nederlandse Vereniging van Advocaten-Belastingkundigen (NVAB)
RU	Palata Nalogovych Konsultantov (Chamber of Tax Advisers)

Standing guest:

UZ	The Chamber of Tax Advisors of Uzbekistan