Dear Sir or Madam,

The Association of International Certified Professional Accountants (“Association”) appreciates the opportunity to provide comments on your public consultation document Secretariat Proposal for a “Unified Approach” under Pillar One (“Pillar One Proposal”).

The Association previously submitted initial thoughts in May on your public consultation document on Addressing the Tax Challenges of the Digitalisation of the Economy as well as additional and more detailed comments on your Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy.

We respectfully submit our general comments on the overall approach as well as input on policy, technical and administrability issues raised. Paragraphs referenced below are paragraphs in the Pillar One Proposal.

General Comments

The Association appreciates the efforts of the OECD in developing the Pillar One Proposal, noting that several of its design components reflect the Association’s four elements necessary to develop a consensus-based, equitable, and successfully durable rebalancing of multijurisdictional taxing rights as discussed in our previous submissions mentioned above.

Scope (Business Models)

The Pillar One Proposal states that the new taxing regime would focus on large consumer or user facing businesses or providers of digital services. It appears, however, that all businesses are in scope of the Pillar One Proposal unless there is a carveout, including

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1 Pillar One Proposal, page 7, paragraph 20.
business-to-business transactions that manufacture products eventually sold to consumers. For example, extractive and commodities industries may receive a carveout since they do not utilize high-value market intangibles. However, extractive industries do not generally sell to individual consumers. Since such industries would receive a carveout, it appears the Pillar One Proposals are not limited to what is generally accepted as consumer-facing businesses. The Association believes that any revised international tax rules should apply consistently and neutrally across all industries and business models, and therefore believes the Pillar One Proposals should make clear that all businesses are within scope. Clarity is needed on how businesses and business lines are defined for purposes of Amounts A and B.

For example, certain forms of business models take the form of:

(i) A digital marketplace where buyers/users and sellers of goods, services, or information are connected;

(ii) A business that manufactures products and sells such products to both individual consumers\(^2\) and business customers;\(^3\) and

(iii) A business which manufactures components that are sold to business customers, who in turn use these components in a further manufacturing process to make products that are sold to consumers.

The use and exploitation of intangible assets and the level of non-physical economic presence in each of these business models are different.

- The first business model, the one that provides the digital marketplace, presumably is a type that is directly targeted by Amount A of the Pillar One Proposal. The economic reach of such activities can generate substantial profits outside of the existing physical presence nexus rules.

- The second business model, whereby a company manufactures goods and sells to both individual consumers and business customers, initially appears to be outside of the highly-digitalized models targeted by Amount A of the Pillar One Proposal. However, although this business model does not provide a digital marketplace platform, such businesses may utilize a digital marketplace for the sale of their products to obtain digitalized data on its consumers, such as product preferences and other highly personalized information. Although the operating margins of

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\(^2\) The term “consumer” as defined in footnote 7 of the Pillar One Proposal “generally refers to individuals who acquire or use goods or services for personal purposes (i.e. outside the scope of a professional or business activity) ...”

\(^3\) The term “customer” as defined in footnote 7 of the Pillar One Proposal “generally includes all recipients of a good or service (including business customers that are not end-users).”
such a retail function would be lower than the higher margins of cloud computing or other digitalized services, the businesses would exploit digital information and marketplace intangible assets to identify and target their marketing efforts, and it appears that such product sales activities would be captured by the new taxing regime. However, clarity is necessary on how Amounts A and Amounts B relate to such activities.

- In the third business model, whereby a company manufactures and sells goods used by another business as component parts in an additional manufacturing process, the company does not utilize marketing intangible assets in marketplace jurisdictions. Excluding this type of business model from Amount A in the new taxing regime appears reasonable. The business is not exploiting its presence in a digital marketplace and the current tax rules appropriately capture and tax the value created. However, the Pillar One Proposal is unclear whether such activities would be subject to Amount B, or if Amount B would only apply to distributors.

The Pillar One Proposal should clearly identify the margins generated by businesses to become subject to Amount A, as well as the types of functions necessary to generate an amount under Amount B.

**Scope (Size of Businesses)**

The Pillar One Proposal suggests that only large consumer-facing businesses should be the focus of the new taxing regime, and that a suggested size limitation for application of the new rules could be the €750 million revenue threshold used for country-by-country reporting.4

This €750 million size proposal appears reasonable, particularly with regards to enforceability. One key difficulty a taxing jurisdiction would experience in enforcing compliance by a non-resident enterprise is for the taxing jurisdiction to identify and quantify the revenue generated within its jurisdiction. If the enterprise does not have a physical presence in a country and does not voluntarily comply with the tax laws, the jurisdiction, without some form of reporting mechanism, may not be otherwise aware of the revenue and would be unable to enforce compliance.

The country-by-country reporting regime provides at least some form of reporting mechanism as each taxing jurisdiction could verify that revenue reported on the country-by-country report is materially similar to revenue reported by the enterprise and on which tax was paid. Therefore, we agree that the application threshold for the new tax regime should not be less than the threshold for the country-by-country reporting purposes.

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However, for this reporting mechanism to be effective, the definition of revenue on the country-by-country report and the definition of revenue under the new taxing regime should be similar. Further, in order to provide a matching mechanism for taxing jurisdictions, the country-by-country report may need to be modified to report on a per-country basis the revenues from activities subject to tax under the Pillar One Proposals.

The Association has concerns on utilizing withholding taxes as a mechanism to collect amounts designated as Amount A,\(^5\) including the following:

- **Losses:** Withholding taxes do not take into account losses, either from the current year or from prior year carry-forward amounts, or for losses generated by related resident companies. It appears unreasonable to subject a company to tax on Amount A when it economically generates a loss.

- **Allocations:** Withholding taxes do not take into consideration the allocation mechanism of Amount A. By its nature, a withholding tax applies a fixed percentage to a base, but the amount of withholding tax attributable to a certain country cannot be determined at the time of a transaction. It appears unreasonable to require withholding tax at the time of a transaction and then require a company to file for a refund, as many countries have historically refused to issue refunds of excess withholding tax.

- **Consumer Transactions:** The Pillar One Proposal focuses on the need to tax value generated in market jurisdictions by consumers, either through social media, provision of digital services (such as the download of entertainment), or other interactions on digital platforms. Individual consumers do not appear the proper parties to act as withholding agents. Based on the U.S. experience with the very high non-compliance rate of individuals remitting uncollected sales and use taxes, it is difficult to expect a high compliance rate of individuals acting as withholding agents on payments related to their online purchases and downloads.

- **Gross versus Net:** Withholding tax is a gross rather than net income tax. Such a gross-income tax does not take into account actual profit margins generated by a business but applies a fixed margin to all transactions. Such a tax is inconsistent with determining Amount A based on an allocated amount of profit.

**A New Nexus Rule for the Taxpayers in the Scope**

The Pillar One Proposal would establish a new nexus rule\(^6\) that would apply “in all cases where a business has a sustained and significant involvement in the economy of a market

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\(^5\) Pillar One Proposal, page 10, paragraph 39.

\(^6\) Pillar One Proposal, page 7, paragraph 21.
jurisdiction, such as through consumer interaction and engagement, irrespective of its level of physical presence in that jurisdiction. The simplest way of operating the new rule would be to define a revenue threshold in the market (the amount of which could be adapted to the size of the market) as the primary indicator of a sustained and significant involvement in that jurisdiction."

This approach is reasonable for two reasons:

(i) **Continuity with traditional PE rules:** A key test of the existing permanent establishment (“PE”) rules is that a taxable presence should be based upon a sustained impact on the economy in the form of a fixed place of business, which is defined by the OECD Model Commentary as “a facility or premises that is established at a distinct place with a certain degree of permanence, and the enterprise carries on business through this fixed place of business.” Therefore, the proposal that a taxable presence under the new nexus rules should also be based upon “sustained and significant involvement in the economy of a market jurisdiction” aligns with the historic PE approach.

(ii) **Avoids capturing de minimis transactions:** Using a revenue threshold avoids applying the new tax regime to companies that generate relatively small amounts of revenue in a jurisdiction, thereby saving both tax administrators and taxpayers the cost and burden of enforcement and compliance when the amount of tax is relatively small.

**Pending Issues (Calculation of Group Profits for Amount A)**

The starting point for the determination of Amount A would be identification of the multinational group’s profits as derived from the consolidated financial statements. The Pillar One Proposal requests comments on specific issues related to this approach which we provide below:

**An appropriate metric for group profits:**

Consolidated financial statements may work well as an appropriate measure of group profits as the financial statements are presumably prepared and independently audited under GAAP or IFRS for large companies with over €750 million in revenue.

However, questions arise on the treatment of minority investments and partnerships. Adjustments should be made to property to take into account only the portion of the minority investment and partnerships owned by the consolidated group, assuming the minority-owned entities and partnerships do not otherwise pay income tax at the entity

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7 OECD Commentaries on the Articles of the Model Tax Convention.
level. If the minority-owned entities and partnerships pay income tax at the entity level, such ownership should be removed from the financial statement tax base.

**Standardized adjustments to be made to adjust for different accounting standards:**

In certain cases, GAAP and IFRS apply different criteria in the timing of recognition of income and expense, and generally, the timing differences are only outstanding from one year to another. There are certain exceptions where income or expenses may be capitalized under one accounting standard but recognized in the current period for another accounting standard, e.g., purchase accounting for the acquisition of a business where certain amounts are capitalized under GAAP or IFRS but expensed under the other system of accounting.

The companies subject to the Pillar One Proposal would generally be limited to consumer-facing businesses and businesses that provide digital services. If the timing differences between GAAP and IFRS only accelerate or defer the recognition of income or expense due solely to timing differences, it appears reasonable to not require any standardized adjustments to the financial statements. Any standardized adjustments to adjust for timing differences that would generally unwind within a short number of years (e.g., differences in depreciation or capital allowance systems) would add complexity and controversy.

**Segmentation by business line**

The Amount A mechanism could be potentially calculated on a business line basis. As further discussed in Paragraph 53, calculation on a business line basis is being considered to avoid the blending of highly profitable business lines with business lines of low profitability, such as a low-margin retain business line with a high-margin cloud-computing business line.

Consideration should be given to the treatment of general and administrative costs generated by the consolidated group that are not attributed to any business line and separately reported. Such general and administrative costs should also be allocated across business lines in a reasonable manner. The best method for allocation may or may not be based upon revenue. However, as the methods used to allocate such general and administrative costs across business lines could be a source of controversy, simplified and standardized approaches are necessary to take such unallocated general and administrative costs into account.

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8 Pillar One Proposal, page 9, paragraph 30.
**Determination of Amount A**

In determining Amount A, the second step would exclude deemed routine profits to identify deemed residual profits. The final step would allocate a portion of the deemed residual profits (Amount A) to market jurisdictions based on an agreed allocation key (such as sales).

Amount A would be determined upon a global, unitary basis, and when determining the deemed routine profits in each jurisdiction, consideration should be given to the functions and activities in a business supply chain in every country.

Any standardized percentages used should be established based on transfer pricing benchmarking for the types of activities and industries involved. Additionally, each country within the Inclusive Framework should commit to apply the same standardized percentages in each country, as applying higher or lower percentages in different countries could cause a portion of the income to be either double taxed or not taxed at all.

The approach of using sales as the sole allocation key is reasonable, as long as the definition of sales is consistently defined across jurisdictions. Using a combination of sales with other factors, such as payroll or property, may arguably provide a more comprehensive connection between the business enterprise and the jurisdiction, but there are concerns. Use of these additional factors could:

1. Increase complexity and the risk of controversy;
2. Reduce the incentive to create jobs and invest in property in the jurisdiction, as increasing these factors would increase the amount of income tax due in that jurisdiction; and
3. Necessitate the inclusion of intangible assets (which are key drivers of digital businesses) as property. However, intangible assets are difficult to identify, value, and geographically locate, and the inclusion of such intangible assets in a property factor would add substantial complexity and controversy.

Therefore, relying upon sales as the sole apportionment factor would retain simplicity and reduce controversy.

Further, as Amount A is determined as a share of the deemed residual profit of the enterprise, no allocation to market jurisdictions would be made under Amount A in the year an enterprise generates a loss. In order to take losses into account in determining the profit allocable under Amount A, the deemed residual profit subject to the Amount A reallocation should be determined net of any loss carryforwards from prior years.
Elimination of Double Taxation in Relation to Amount A

It is important that all countries apply the same approach in determining the portion of Amount A that is deemed a routine profit, including applying the same standardized formula percentages and rules for allocation. Otherwise, there is a significant risk of double taxation.

As each jurisdiction would apply a minimum revenue threshold before profit becomes taxable in such jurisdiction, there is also a risk that profit, generated in a jurisdiction that is below the minimum threshold, would not be taxable anywhere. Therefore, income not subject to tax anywhere should be taxable in the parent company jurisdiction.

Similarly, the parent company jurisdiction should provide relief for double taxation in the form of a foreign tax credit or income exemption for income that is taxed in both the parent jurisdiction and another jurisdiction, similar to the current system.

As the new taxing regime would only apply to certain consumer-facing businesses or businesses that provide digital services, the existing mechanisms for eliminating double taxation should continue to operate as they currently operate in relation to income not subject to the new taxing regime.

Income subject to tax under the new taxing regime would need a new mechanism for dealing with double taxation due to the apportionment of such income across multiple jurisdictions. For example, under the current international system, a dispute over the allocation of profits generally occurs in a bilateral context, that is, between two countries such as in the case of a transfer pricing adjustment. However, under Amount A, a deemed residual profit would be allocated between multiple market jurisdictions, and if one or more of those jurisdictions challenge the amount of profit allocated to it, such challenge in effect is challenging the profit allocated to all market countries that received such allocation.

In such a case, double taxation or non-taxation could arise unless a multilateral dispute mechanism is available to review the challenge and, if appropriate, reallocate the income between all countries receiving the allocation.

Such disputes might arise under a number of scenarios, but of particular concern are scenarios where:

(i) One or more countries adopt or apply baseline percentages other than the international standardized percentages; or

(ii) One or more countries characterize an enterprise or business as operating in one industry (and apply the percentages according to that characterization) but
other countries characterize the enterprise or business line as operating in another industry (and apply a different set of baseline percentages).

Regardless of cause, the use of different percentages could either cause double taxation or non-taxation of profit, if the percentages are higher or lower, respectively, than the internationally-agreed percentages. Jurisdictions could challenge the allocation of profit under Amount A and, absent an administrative mechanism to reallocate profit in a multilateral context, a successful challenge by a jurisdiction could lead to double taxation.

The current bilateral-based Mutual Agreement Procedure (“MAP”) as contained in existing bilateral tax treaties could not manage such a multilateral scenario. Instead, a multilateral solution should be provided, either through a multilateral forum or organization designated or designed to timely resolve such challenges. Mandatory binding arbitration is a practical and reasonable solution for multilateral disputes, as the views of all parties could be taken into consideration by a third-party arbitrator. Regardless, any solution should avoid the historical problems inherent in the bilateral MAP process by ensuring enterprise participation in the resolution process, and requiring dispute resolution within a timely basis, such as two years, before triggering a binding arbitration process.

We agree with Paragraph 30 that binding arbitration and potentially, other dispute resolution mechanisms, should apply to all elements of the Pillar One Proposal (i.e., Amounts A, B, and C).

**Amount C / Dispute Prevention and Resolution**

*Dispute prevention and resolution*

The existing MAP process under bilateral treaties has generally been effective at resolving matters of double-taxation; however, the MAP process has at least three severe flaws:

- Businesses have not been allowed to participate in the MAP process, which has been limited to discussions between the competent authorities of the countries at issue. Therefore, transparency to businesses has been limited, and businesses have not been certain that the competent authorities in each country have been deciding their cases by taking into consideration the proper or complete facts and analysis.

- MAP cases have not historically had a required time limit for settlement, and thus in some cases, MAP cases have lingered for multiple years with no action by the competent authorities.
MAP does not require authorities to resolve the issues of double taxation, as MAP only requires tax authorities to discuss, not settle, the cases. Therefore, although a tax treaty may be in effect, taxpayers may, after waiting several years for the competent authorities to consider their case, end up without relief and face a double taxation situation.

Any new dispute resolution system should be designed in a way to mitigate these flaws, especially as a dispute over profit allocation would impact not just two countries, but all of the multiple countries that received a profit allocation.

Mandatory binding arbitration is a practical and reasonable solution for multilateral disputes, as the views of all parties could be taken into consideration by a third-party arbitrator. Additionally, binding arbitration has been proven to encourage parties in a bilateral dispute to settle MAP issues earlier to avoid initiating the arbitration process, and such a mechanism to encourage timely consideration of disputed cases should be utilized.

**Enforcement Mechanisms**

Under the current international system, a physical presence is required to impose taxation. Physical presence allows jurisdictions to sanction persons or property in the event of noncompliance with their filing or payment obligations. Non-physical presence nexus does not provide such a sanctioning mechanism.

Any enforcement mechanism should be well publicized, transparent, predictable, not discriminatory against foreign enterprises, and provide administrable and functional methods of appeals. These rights should include access to local country court systems and other judicial remedies, even where a taxpayer has no physical presence in a jurisdiction.

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The Association of International Certified Professional Accountants is the most influential body of professional accountants, combining the strengths of the American Institute of CPAs (AICPA) and The Chartered Institute of Management Accountants (CIMA) to power opportunity, trust and prosperity for people, businesses and economies worldwide. It represents 650,000 members and students in public and management accounting and advocates for the public interest and business sustainability on current and emerging issues. With broad reach, rigor and resources, the Association advances the reputation, employability and quality of CPAs, CGMAs and accounting and finance professionals globally.
We appreciate your consideration of our thoughts and welcome the opportunity to discuss them further. Please feel free to contact Samantha Louis, Association Vice President – Global Advocacy at samantha.louis@aicpa-cima.com, or +44 (0) 203 814 2205; or Edward Karl, Association Vice President – Taxation at edward.karl@aicpa-cima.com, or +1 202 434 9228.

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