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OECD
Task Force on the Digital Economy

FROM Loyens & Loeff N.V.
REFERENCE 31721410
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RE Tax challenges of the digitalised economy – OECD Secretariat Proposal

Dear Sirs and Madams,

We have noted with interest the OECD Secretariat Proposal for a “Unified Approach” under Pillar One (the **Proposal**). We are grateful for being offered the opportunity to share our views and considerations on this topic.

Prior to answering the different questions (see the annex), we would like to suggest a modest change to your Proposal in section 1 to address harmful elements it entails. Furthermore, to facilitate the understanding of our answers to your questions, we reflect two different views on the working of your Proposal in section 2. We would like to stress that these replies do include important suggestions to reduce the Proposal’s disruptive elements.

1 Suggested change

In this section, we make high-level recommendations on amending your Proposal to facilitate its integration in the current international tax paradigm. Our approach would address the inherent flaws of the current at arm’s length system due to the separate entity approach not always accounting for the economies of scale and/or benefits of integration resulting from the membership of a Multinational Enterprise (**MNE**) (see paragraph 1.10 of the 2017 OECD transfer pricing guidelines for tax administrations and multinational enterprises (hereafter, **2017 OECD TP Guidelines**)). We suggest to use the current transfer pricing (**TP**) system to allocate the at arm’s length profit to all the members of an MNE in line with their specific functions and risks. If this is done correctly, there should be an excess that will be the result of these mentioned benefits . Under the current system this excess profit is allocated to the principal within the MNE. This excess profit could better be divided between all market jurisdictions involved, relying on your suggested allocation mechanism to allocate such to these market jurisdictions. This approach should mitigate even further the risks of double taxation and still allocate a significant portion of profit to the market jurisdictions that are currently not allocated any profit in this respect. This allocation of the excess profit from the

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economies of scale and/or benefits of integration will be at the cost of jurisdiction that currently may now tax these profits.[1]

To determine the excess profit within this alternative system, we suggest to start with the overall profit of the MNE. From this overall profit the remuneration based on the current at arm's length principle as applied correctly by the jurisdictions involved will be deducted,[2] which will result in the remuneration for the economies of scale and/or benefits of integration (reference again to paragraph 1.10 of the 2017 OECD TP Guidelines). This resulting amount (i.e. the excess profit) can be allocated to the entities in user/market jurisdictions.

2 Understandings of your Proposal

Tax experts in our firm had different views on the workings of your Proposal. However, all experts agreed that you propose a system that would be challenging to integrate in the current international tax paradigm and almost unavoidably leads to double taxation that needs to be resolved through mutual agreement procedures (**MAPs**) or other forms of dispute resolution. Two different understandings of the Proposal are thus set out below, with the second one being an approach that conceptually tries to minimise the conflicts with the existing tax rules and mitigate the structural risks of double taxation. The answer to question 5, in particular, is drafted on the basis that the second understanding is appropriate.

2.1 Understanding 1: the Proposal is an overlay to the existing tax framework

We understand the Proposal in such a way that, in fact, it suggests to add an overlay to the existing international tax framework. The overlay, as it appears, would apply to big MNEs (i.e., having revenues exceeding for instance EUR 750 million) with 'consumer facing business models', or at least to those big MNEs operating business models other than those explicitly carved out (e.g. extractive industries, commodities, financial services). It could be considered to have a variable local sales threshold, which depends on for example GDP, in order to neutralize the effects of different sizes of market jurisdictions.

We will make no comments on what would be appropriate industries to be carved out, as that is a more "political" consideration. For these ring-fenced enterprises, first, the traditional TP model would be modified by introducing a presumed level of remuneration – referred to as Amount B – for so-called 'baseline marketing and distribution functions'. The presumed level would be determined using a fixed remuneration and applied as a basic assumption, where the appropriate fixed remunerations still need to be established. Jurisdictions that would make a case that more than these baseline functions are performed could apply a higher remuneration – referred to as Amount C – based on existing TP rules.

[1] The allocation of this profit to the market jurisdictions may, in practice, lower the taxable results of the entities that are currently the recipients of this excess profit.

[2] If the at arm's length principal is not applied correctly, such results in differences and not a correct determination of the remuneration for the economies of scale and/or benefits of integration.

On top of this, a newly devised tax base division system ('new taxing right') would cater for apportioning tax base – referred to as Amount A – to market jurisdictions. For this purpose, a fixed percentage (possibly with industry-specific variants) would be taken from the MNEs commercial accounting profits (GAAP, IFRS, etc.) and allocated to market jurisdictions by reference to a quantitative turnover threshold test for nexus purposes and a sales-based formula factor for tax base division purposes. The percentages must still be established. The interaction between the fixed remuneration of baseline functions of Amount B, the remuneration based on existing TP rules of Amount C and the 'new taxing right' of Amount A will likely result in many cases of double taxation and require an effective multilateral mechanism to resolve these disputes.

As Amount A is a mostly deemed amount, that uses a different taxable base (total MNEs value instead of a per entity approach), the Proposal will result in the taxation of more than 100% of the MNE's profits. This is caused by the fact that the new taxing right functions as an overlay and Amount A as well as Amount B/C are calculated independently from each other. Where, in practice, the existing framework (Amount B/C) and the new taxing right (Amount A) come together, substantial alignment issues are expected to arise.

Consequently, we believe that the successful incorporation of Amount A into the current international tax framework would require a certain degree of tax harmonization on a global scale. The international tax framework has been successfully amended once before, through the multilateral instrument (**MLI**). Another kind of multilateral instrument, amending existing tax treaties and perhaps introduce a tax treaty where there is no bilateral treaty yet, could as such resolve the issues described above. However, all treaties should be amended the same way and should thus not contain options for the jurisdictions. This would require all jurisdictions to agree with each other, different from the MLI. During the MLI discussions it proved impossible for all jurisdictions to agree with each other. As such, the MLI contains a few minimum standards, but mostly it is an 'à la carte'-menu. We therefore see a risk that jurisdictions may not agree on a universal and simultaneous implementation. The new instrument should in any case contain provision with respect to:

– Subject of taxation. As the new taxing right introduces a new taxpayer, this new taxpayer will have to be defined in the relevant tax treaty. We believe this definition should be twofold, as it should include the identification and tax liability under the new taxing right of the relevant MNE and it should include tools and/or rules for the identification of the members of that MNE that should be considered to own the profit that is allocated under Amount A (the "owning companies").

– Object. The introduction of the new taxing right calls for the introduction of a new description and taxation right allocation provision. Important questions that will in this respect have to be answered are for example what the hierarchy between the different amounts will be and when and how the right of taxation will be allocated to a certain jurisdiction, as we believe the object and purpose of this Proposal could not be to drain all

profits from purely production jurisdictions. Clear provisions and guidance are as such of importance in this respect.

– Geographic nexus. As a certain physical presence is no longer required a new geographic nexus should be introduced on the basis of which a jurisdiction is allocated the right to tax Amount A. This geographic nexus should include the way the aforementioned "owning companies" are geographically pinned down.

– Elimination double taxation. As the introduction of the new taxing right involves the amendment of the entire international tax framework and amongst others, the introduction of a new taxpayer and geographic nexus, the article for the elimination of double taxation would require amendment in line with the additions/amendments made throughout the relevant tax treaty.

– Mandatory dispute resolution. The introduction of the new taxing right parallel to the existing tax framework is bound to give rise to double taxation due to interpretation differences between or different opinions of jurisdictions, even if clear rules and guidance are provided. As such mandatory and binding dispute resolution mechanisms are necessary to ensure single taxation. Mandatory dispute resolution mechanisms can for example be found in the following:

  - Mandatory Binding Mutual Agreement Procedures (**MBMAP**). MBMAP can be a very helpful tool as it forces jurisdictions to work together and solve their differences and the outcome is binding for the participating jurisdictions. However, as the double taxation issues that arise due to the introduction of the new taxing right, could actually arise between multiple jurisdictions and not just in bilateral relations, the idea of a Multi MBMAP should be explored. Such a Multi MBMAP would force multiple jurisdictions to agree and can as such not limit one jurisdiction in other MBMAP procedures when the outcome of the MBMAP with another jurisdiction is already agreed upon. Please see the answer to question 7 (Practical experience with MAP) for some issues that will need to be resolved in order for MBMAP to become an effective dispute resolution mechanism.

  - Binding arbitration. Binding arbitration could be a very helpful tool for dispute resolution. This would however require clear provisions and guidance with respect to the procedure, specifically the appointment of the independent arbitrators and the duration of the procedure. The option of a new international (arbitration) tax court with independent arbitrators could be explored.

2.2 Understanding 2: step-by-step approach, with arm's length remuneration of routine functions taking precedence over any reallocation of taxing rights to market jurisdictions

In this second understanding, to mitigate as much as possible the structural potential for double or multiple taxation, the Proposal should in our view entail the following steps in the allocation of taxing rights and of a MNEs profits between jurisdictions.

Step 1: Determination and allocation of the deemed routine profit attributable to marketing and distribution functions (Amount B)

Under Amount B, a remuneration for baseline marketing and distribution functions in market jurisdictions should be determined following the traditional OECD TP rules, although the possibility of using a fixed remuneration must be "explored".

Chapter 7 of the 2017 OECD TP Guidelines provides bespoke provisions for low value-adding intra-group services, which are (i) of supportive nature, (ii) not part of the core business, (iii) not required or involved in the creation of unique and valuable intangible assets and (iv) low-risk bearing. Under the 2017 OECD TP Guidelines, the remuneration for such services could as a general rule be a cost plus 5%. We note, however, that the 2017 OECD TP Guidelines do not define routine marketing and distribution functions/services. To ensure Amount B is interpreted and computed consistently across jurisdictions, it would be useful to define such routine functions.

Step 2: Determination and allocation of the deemed routine profit attributable to others factors (Amount C)

Under Amount C, routine and non-routine functions must be identified and may be remunerated in line with the current TP framework. In this second step, we think the routine functions other than baseline marketing and distribution functions should be remunerated. The 2017 OECD TP Guidelines could provide initial guidance (as regards the remuneration of low value-adding intra-group services could be used as mentioned in step 1). This approach seems logical and legitimate, as Amount A is a "residual profit" after remunerating routine functions.

Albeit the remuneration of routine services may appear relatively straightforward, the definition of what is a routine function/service should be clarified to avoid overlaps between Amounts A, B and C in this respect.

Step 3: Determination and allocation of the deemed residual profit attributable the market (Amount A and Amount C)

a) Split of the deemed residual profit between the *deemed residual profit attributable to market jurisdictions* and the *deemed non-routine profit attributable to other factors.*

Under Amount A, a portion of the *deemed residual profit attributable to the market* must be determined. This involves a split of the deemed residual profit between the deemed non-routine profit attributable to the market and the one attributable to other factors such as trade intangibles or capital and risk. The OECD has not provided a limitative list of what should be considered as 'other

factors'. We see here a significant risk of overlap if there is no clear guidance and consistent practice across members of the OECD Inclusive Framework (and more broadly).

However, the proposed method is to multiply the non-routine profit, which had been determined by excluding amount B and a part of amount C (cf. steps 1 and 2 above), by an internationally agreed fixed percentage.

This fixed percentage could be subject to many variables, such as industries, regions or markets.

Once the deemed non-routine profit attributable to the market has been identified, it has to be shared between the market jurisdictions.

b) Allocation of the *deemed residual profit attributable to market jurisdictions* between the different market jurisdictions.

Under Amount A, each market jurisdiction will be entitled to tax a portion of the *deemed residual profit attributable to the market.*

According to the new nexus rules proposed under the "Unified approach", the profit will be taxed in a market jurisdiction if the revenue threshold is met in that jurisdiction. This threshold would be largely based on sales.

Subsequently, each market jurisdiction will be allowed to tax a portion of the *deemed residual profit attributable to the market* according to an allocation key based on sales. This taxation will be charged on the entity entitled to the deemed non-routine profit by each market jurisdiction. Potentially, there could be a joint liability of a subsidiary with physical presence in the market jurisdiction (cf. example p.21).

Based on the above, we consider that the risk of double taxation is most likely to arise in the following circumstances:

- Countries disagree on the scope of the routine functions to be remunerated under steps 1 and 2.
- The overlap between Amount A and Amount C – as both tax the "residual profit" after remunerating the routine functions targeted under steps 1 and 2.
- Countries apply different benchmarks to assess their entitlement to a portion of Amount A, so that in aggregate they tax more than 100% of Amount A.
- Countries tax two or more different group companies on the same portion of amount A allocable to that country.

Yours faithfully,
Loyens & Loeff N.V.

Annex – Observations in respect of Questions 3 – 7

As Loyens & Loeff is a law firm, we limit our input on the consultation to the technical input requested by questions 3-7. Any political aspect to the questions is left to the members of the OECD Inclusive Framework to agree on.

Question 3: Calculation of group profits for Amount A

The starting point for the determination of Amount A would be the identification of the MNE group's profits. The relevant measure could be derived from the consolidated financial statements. In your view, what challenges and opportunities arise from this approach? Please consider in particular:

a. what would be an appropriate metric for group profit;

b. what, if any, standardised adjustments would need to be made to adjust for different accounting standards; and

c. how can an approach to calculating group profits on the basis of operating segments based on business line best be designed? Should regional profitability also be considered?

Answers A/B

We acknowledge that there are many challenges in relation to the determination of the MNE's group profits. Many of these challenges have already been subject to discussions in relation to: (i) the application of the transactional profit split method and (ii) country-by-country reporting (**CbCR**). Our recommendation is to build on these experiences to determine the MNE group's profits, particularly as the Proposal states that the approach to calculate Amount A would also replicate features of the residual profit split method.

With respect to the application of the transactional profit split method, the following elements have e.g. been mentioned in the 2017 OECD Guidelines:

"Generally, the combined profits to be split in a transactional profit split method are operating profits. Applying the transactional profit split method in this manner ensures that both income and expenses of the MNE are attributed to the enterprise on a consistent basis. However, occasionally […]." (paragraph 2.137).

and

"In order to determine the combined profits to be split, the accounts of the parties to the transaction to which a transactional profit split is applied need to be put on a common basis for accounting practice and currency and then combined. Because accounting standards can have significant effects on the determination of the profit to be split, accounting standards should be selected in

advance of applying the method and applied consistently over the lifetime of the arrangement" (paragraph 2.131).

and

"Financial accounting may provide the starting point for determining the profit to be split in absence of harmonized tax accounting standards. The use of other financial data (e.g. cost accounting) should be permitted where such accounts exist, are reliable, auditable, and sufficiently transactional. In this context, product-line income statements or divisional accounts may prove to be the most useful accounting records" (paragraph 2.132).

Taking into account the above quotes – that relate to the application of the transactional profit split method – as well as the experiences we have with respect to CbCR, we have reached the following conclusions:

– It would in our view be practical and consistent to also use the operating profits as a starting point for the identification of the MNE group's profits.

– Taxpayers should have the flexibility to choose one accounting standard, as long as such choice is made consistently over the lifetime of the arrangement. Such choice should, e.g., be made by the Group's Ultimate Parent Company (the same as the Ultimate Parent Company for CbCR purposes). To oblige a taxpayer to reconcile the financial data of each group entity to GAAP, IFRS or other accounting standards would trigger unreasonable efforts (i.e. additional compliance burden) for the taxpayers.

Answer C

As described above, the MNE should in our view have the flexibility to choose an appropriate way of determining the MNE's group profits used to determine Amount A as long as such choice is applied consistently. We believe that it should indeed be possible to use divisional accounts to segment between business lines.

Furthermore, we believe that it would not be appropriate to use regional profitability. From the contents of the Proposal, we derive that the aim of the Unified Approach is to allocate profits to market jurisdictions (thereby (partially) moving away from the arm's length principle, whereby the existing TP rules are still predominantly used to ultimately allocate profits to the various countries). Regional profitability should in our view be already captured while applying the existing TP rules (i.e., by way of a proper comparability analysis). In case regional profitability were applied, this would in our view be a further deviation from the arm's length principle, which we do not recommend.

Question 4: Determination of Amount A

In determining Amount A, the second step would exclude deemed routine profits to identify deemed residual profits. The final step would allocate a portion of the deemed residual profits (Amount A) to market jurisdictions based on an agreed allocation key (such as sales). In your view, what challenges and opportunities arise from this approach?

Opportunities

- In the current TP framework, the synergy profits are allocated to the principal. We understand it is the OECD's intention to design a solution that would reallocate taxing rights (i.e. allocating residual profits) in favour of the market/user jurisdictions without the need of a physical presence. This in order to recognize that there is value being generated in the market/user jurisdictions that is not recognised in the existing international tax framework.

- Furthermore, we support the approach using simplifying conventions which search for simplicity and increase tax certainty for taxpayers. The proposed formulaic approach reduces subjective judgements and discretion.

- As stated in the Proposal, the new taxing right replicates features of the formulary apportionment method (through a formula based, e.g., on sales). The 2017 OECD TP Guidelines recognises in paragraph 1.22 that in order to properly implement a formulary apportionment system that ensures single taxation while sheltering against double taxation, international coordination and consensus on the formula is required. Therefore, we support the OECD's aim to have common agreement on the formula, accounting systems, etc. to adopt the approach.

- In addition, we agree that with the factor sales in the formula it is hard for a MNE to artificially shift profits to low taxed jurisdictions since this factor cannot be manipulated.

Challenges

- Keeping the goal of simplifying the international tax framework in mind to contain the increasing administration and compliance costs of trying to apply the arm's length principle, we must conclude that with the introduction of this "overlay" to the (already complicated) existing framework actually the opposite is being achieved. The question is how this new rule (i.e., Amount A calculated based on a formulary apportionment) will be reconciled with the already existing TP rules. This would result in all kinds of problems, e.g., double taxation and tax disputes, as the additional Amount A income that is going to be allocated to the market/user jurisdictions should come out of the taxable base of another jurisdiction.

- As set out above, this approach searches for simplicity. However, we feel that special consideration should be given to the fact that the four-step approach (in order to calculate

Amount A) is based on simplified conventions. Although the supporters of the formulary apportionment method are of the view that this approach is more in line with economic reality (reference is made to paragraph 1.19 of the 2017 OECD TP Guidelines), we are concerned that excluding deemed routine and deemed residual profits does not meet this objective. More specifically, the Proposal recognises (reference is made to footnote 6) that it seeks to *"approximate, without precisely quantifying, the amount of residual profit of a MNE group".* We question whether for determining the market share, connection is sought to the place where the value is actually being created. In this respect, the 2017 OECD TP Guidelines acknowledge that:

> *"One such concern is that predetermined formulae are arbitrary and disregard market conditions, the particular circumstances of the individual enterprises, and management's own allocation of resources, thus producing an allocation of profits that may bear no sound relationship to the specific facts surrounding the transaction (paragraph 1.25)."*

We are concerned that the deemed residual profit used for Amount A will not result in a 'fair' outcome. In this context, it is our view that it would also be impossible to determine a fair deemed return for all industries.

- The OECD proposes an allocation key that is exclusively based on sales. Although we support the OECD's view that the sales factor is objective and not easily manipulative (see above), we are concerned that a formula based on sales only is not well balanced and does not reflect the value created along the supply chain. More specifically, we fear that developing countries may argue that they are entitled to a higher return based on Amount C (i.e., in case these countries take the position that there are more functions in the market jurisdiction than have been accounted for) resulting in tax disputes. This may be neutralized by application of a formula that includes sale, asset and employees.

General comments

- We encourage the OECD to introduce measures to carry over past losses, without any time restriction on the utilisation of such losses. The Proposal acknowledges that Amount A has effective application to both profits and losses, and in practice we see that certain highly digitalized MNEs can be loss-making while still being considered a viable business.

- Special consideration should be given to the fact that enforcement and collection of taxes will be more complex now that countries will be confronted with additional compliance obligations in jurisdictions where they are currently not a taxpayer.

- From a practical perspective, it will be challenging to track down the location of the revenues generated from third-party sales as well as to cope with non-paying users.

Question 5: Elimination of double taxation in relation to Amount A

What possible approaches do you see for eliminating double taxation in relation to Amount A, considering that the existing domestic and treaty provisions relieving double taxation apply to multinational enterprises on an individual-entity and individual-country basis? In particular, which challenges and opportunities do you see in:

a. identifying relevant taxpayer(s) entitled to relief;

b. building on existing mechanisms of double tax relief, such as tax base corrections, tax exemptions or tax credits; and

c. ensuring that existing mechanisms for eliminating double taxation continue to operate effectively and as intended.

As mentioned in introduction, the interaction between Amount A and Amounts B/C, as well as the allocation of Amount A between the different jurisdictions where (significant numbers of) consumers are located (hereafter "consumer jurisdictions"), are liable to give rise to double taxation.

In our view, preventing double taxation involves the following two requirements that must be the subject of a global (or, initially, at least OECD-wide) consensus if the Unified Approach on Pillar One is to have any chance of resolving tax challenges arising from the digitalisation of the economy in a coordinated manner and without stifling investment and innovation:

- Setting mandatory rules on the allocation of a group's profits between Amounts A, B and C – this is the subject of some of the other questions in this consultation.
- Determining which group entities may be taxed by consumer jurisdictions under Amount A. This will also help determining which taxpayers are entitled to relief.

On the latter point, we think the following stances would be reasonable:

- Entities that only perform services falling in the scope of Amount B should not be taxed by any other country under Amount A. These entities will be remunerated in accordance with Amount B rules (and should not have additional income/profits), and will be taxed in their jurisdiction of residence. The profits of these entities should thus not be included in a MNEs profits potentially subject to consumer jurisdictions' taxing rights under Amount A.
- The same should apply for entities that perform other routine functions (but not non-routine functions) that may be remunerated under Amount C. As Amount A is supposed to reallocate taxing rights on a portion of the residual profit, logically any routine remuneration should not be included in the pool of profits potentially subject to new taxing rights under Amount A rules.

- Where one or more entities of an MNE group are resident in a consumer jurisdiction that gets additional taxing rights under Amount A, that jurisdiction should levy tax under Amount A in priority from these entities.

Thus, there remains the case where a consumer jurisdiction is allowed under Amount A rules to tax the profits of a group that has no physical taxable presence in that jurisdiction – either through a subsidiary or a permanent establishment. In this type of situations, the following principles would help prevent double or multiple taxation:

- Lossmaking entities should in principle not be subject to taxation under Amount A rules (and should therefore not need double taxation relief). The Unified Approach refers to taxing *profits*, not gross income (like the proposed digital services taxes considered or introduced in various countries). If an entity realises a loss, it means that it exercises more functions and/or takes more risks than mere routine functions (which should normally not give rise to losses if the remuneration is determined under a cost-plus approach).
- Where MNEs are organised (or split their financial reporting) around geographical lines, consumer jurisdictions should not be allowed to tax non-resident group entities whose residual profits are exclusively derived from another geographical segment/market.

Depending on how the split between Amount A and Amount C is done, i.e., how much weight is given to non-routine functions and how much to consumers, the consumer jurisdictions may have a more or less wide selection of group entities to tax. The more remuneration is allocated in priority to non-routine functions (in line with current TP guidance and principles), the more consumer jurisdictions should focus on taxing (only) entities that have a rather passive functional profile and accumulate residual profits from, e.g., intragroup licensing, financing activities or remote online sales. Any entity subject to tax under Amount A should be entitled to claim double/multiple taxation relief.

Another possible approach would be that the consumer jurisdictions are only allowed to tax the head of the MNE on the appropriate portion of residual profits allocated to consumer jurisdictions. The head of the group could then – in order to report a sufficient amount of profits – claim intragroup adjustments from subsidiaries that actually owned the residual profits, and these adjustments would be deductible in the country of the subsidiary. This would appear at first sight easier for consumer jurisdictions, but it would make the double taxation relief more complex, as the adjustment would take place between the jurisdiction of the MNE group's head company, and the jurisdictions of the entities that contractually earned the residual profits, but would not directly involve the consumer jurisdictions.

As mentioned earlier, it is crucial that all countries involved accept the need and appropriateness of the adjustments and the reallocation of taxing rights, in order to be effectively able to rely on mechanisms to avoid double or multiple taxation. Achieving this outcome requires developing

detailed sets of rules, taking into account industry specificities (as acknowledged by the OECD Secretariat in its Proposal).

We advise to further examine the topic of double/multiple taxation relief once there is consensus on how to allocate profits (and how much of them should be allocated) to consumer jurisdictions under Amount A.

Question 6: Amount B

Given the large number of tax disputes related to distribution functions, Amount B of the "Unified Approach" seeks to explore the possibility of using fixed remunerations, reflecting an assumed baseline activity. What challenges and opportunities does this approach offer in terms of simplification and prevention of dispute resolution? In particular, please consider any design aspects and existing country practices that could inform the design of Amount B, including:

a. the need for a clear definition of the activities that qualify for the fixed return; and

b. determination of the quantum of the return (e.g., single fixed percentage; a fixed percentage that varied by industry and/or region; or some other agreed method).

General comments/opportunities

- We support the comments made in the Proposal that the Unified Approach largely maintains the TP system that is currently in place based on the arm's length principle, but that the approach supplements this principle using a formulaic approach where tensions in the current TP system are the highest. We agree with the Inclusive Framework members' opinion (see paragraph 17 of the Proposal) that the current TP system works reasonably well to price routine transactions, but that you can doubt whether this system results in a desired outcome in all situations.

- We support the objective to achieve simplicity to reduce the complexity of the current TP rules and to increase tax certainty for taxpayers. A global approach using fixed remunerations could be considered as a safeguard for taxpayers' rights. Furthermore, we agree that simplified measures would be desirable in order to reduce the increasing compliance costs of complying with the arm's length principle. This has also been specifically acknowledged by the OECD in the 2017 OECD TP Guidelines paragraphs 4.105-4.108, 4.127 and 4.129-4.130. The 2017 OECD TP Guidelines amongst others state that the *"application of the arm's length principle may require collection and analysis of data that may be difficult or costly to obtain and/or evaluate. In certain cases, such compliance burdens may be disproportionate to the size of the taxpayer, its functions performed, and the transfer pricing risks inherent in its controlled transactions".*

  A decrease to a taxpayers' compliance costs can be achieved by allowing the taxpayer to use a fixed return, i.e., "safe harbour" as defined in paragraph 4.102 of the 2017 OECD TP Guidelines, without any further justification and/or analysis. In this way, the burden of proof with respect to the level of return automatically lies with the tax authorities instead of the taxpayer who in the current tax framework first needs to perform a benchmark study to determine an appropriate level of return. We suggest to discharge taxpayers from certain documentation requirements otherwise enforced by the current TP rules that are in place.

Challenges

- Although question 6 of the Discussion Draft does specifically ask for comments regarding Amount B, we take the view that Amount B cannot be assessed in isolation without including Amount C in the analysis. In our view, Amount B and Amount C are intertwined. Please note, that we have taken this into account while answering question 6.

  We fully support the objective to explore the possibility of using fixed remunerations with respect to marketing and distribution activities if this could provide certainty to taxpayers and lower the risks of disputes. However, it is questionable whether these objectives will be achieved under the current Proposal. This as we are of the view that the guidance provided with regard to Amount B and Amount C is currently too vague and leaves considerable room for interpretation.

  - For example, no clear definition of '**baseline activity'** is provided in the Proposal. This creates a very significant risk of double counting between Amount B and Amount C. Under Amount B, the taxpayer can be confronted with a fixed remuneration reflecting an assumed baseline activity, and under Amount C the taxpayer can be taxed on the additional functions than have been accounted for by the assumed baseline activity which is taxed under Amount B. We fear that an unclear definition of baseline activity opens the doors for tax authorities to take the position that (i) more functions are being performed in their jurisdiction; or (ii) the marketing and distribution activities go beyond the baseline level of functionality and warrant a profit in excess (see paragraph 64 of the Proposal), that should in their view be taxed under Amount C. This will create misinterpretations (including disagreements) between the different tax authorities involved, to the disadvantage of the taxpayer.

  - In addition, it is not clear whether a baseline activity includes marketing and distribution activities or whether these type of activities should be assessed separately. Confusion is created by the sentences: "*a fixed remuneration for <u>baseline marketing and distribution functions…</u>" (page 6 discussion draft) and "… for certain 'baseline' <u>or</u> routine marketing and distribution activities..." (paragraph 62 discussion draft).*

    Based on the above, we suggest that the OECD provides us with more guidance to prevent discussions between taxpayers and tax authorities that may result in double taxation and/or tax disputes. We support that a clear definition of the activities that qualify for Amount B is necessary.

  - Moreover, we are of the view that there is also a need to develop a clear definition of '**jurisdiction'**. The Proposal indeed only addresses the activities that are taking place in market jurisdictions (see for example paragraphs 62 and 64 of the Proposal). The question that arises is under which amount (A / B or C) activities will be rewarded if they

are not taking place in a market jurisdiction? For example, what will happen with e.g. production activities or contract R&D activities that are being performed by a group entity in a jurisdiction were no sales are being conducted by the MNE group? Will these activities be caught under an additional amount, e.g. Amount X or under the proposed Amount C? We suggest to clearly define which type of jurisdictions will fall within the scope of Amount C. We propose to include all the jurisdictions in which the MNE group operates (i.e. so that there will be no room for an Amount X) since binding and effective dispute prevention and resolution mechanisms will be specifically designed under Amount C. This will give the taxpayer more certainty that double taxation will be eliminated.

- The wording of the Proposal indicates that one fixed return will be established to remunerate routine marketing and distribution activities. We question whether this would be possible, because different business models can be distinguished from a TP perspective. An entity may operate e.g. as an agent, commissionaire, limited risk distributor or full-fledged distributor. We do not take the view that it is 'at arm's length' that these different types of entities will receive the same fixed return for their marketing and distribution activities, because different types of risks are involved amongst the different business models. For this reason, we propose a fixed percentage that varies **by business model** (e.g. applying the Transactional Net Margin Method with a return on sales of X% for a commissionaire and a return on sales of Y% for a limited risk distributor). However, special consideration should be given to full-fledged distributors / full buy and sell entities. It is questionable whether a fixed return would be appropriate for these types of entities.

- In addition to the above, we propose a fixed percentage that varies **by industry**. We are of the view that the example given in the Proposal (see paragraph 53) with respect to Amount A – a company that operates low-margin retail business with a high-margin cloud-computing business line – also applies to Amount B. We acknowledge that *"[…] distortions would arise that could benefit jurisdictions where the retail sales are concentrated, at the expense of jurisdictions where cloud-computing sales occur".*

Question 7: Amount C/dispute prevention and resolution

In the context of Amount C of the "Unified Approach", what opportunities do existing and possible new approaches to dispute prevention offer to reduce disputes and resolve double taxation? In particular, what are your experiences with existing prevention and resolution mechanisms such as:

a. (unilateral or multilateral) APAs;

b. ICAP; and

c. mandatory binding MAP arbitration?

1 General

- Introduction of a "new taxing right" under the "Unified Approach" is bound to give rise to new issues and double taxation of taxpayers in multiple jurisdictions. Efficient and effective dispute resolution mechanisms should be introduced to solve these issues and resolve double taxation for taxpayers, preferably upfront, and in any case afterwards.

- Mechanisms for dispute prevention and resolution should be laid down in tax treaties, as is currently also the case for bilateral dispute resolution mechanisms. However, this requires a total overhaul of the respective tax treaties to incorporate the "Unified Approach" therein. Since the issues are not expected to remain merely bilateral but to arise in a multilateral context, tax treaties need to be amended in a similar manner to ensure they align and provide an efficient and effective mechanism for taxpayers. This requires a new mandatory multilateral instrument (**MLI**) as part of the "Unified Approach" to introduce these mechanisms in tax treaties simultaneously.

- During the discussions on the current MLI, it proved impossible for all jurisdictions to come to a full consensus. As such, the MLI contains a few minimum standards, but mostly is an 'à la carte'- menu. Question is whether jurisdictions would be willing to agree with each other, especially to the mandatory introduction of mechanisms as part of the "Unified Approach".

- Also, to effectively solve double taxation situations under the "Unified Approach", the possibility to utilise dispute resolution mechanisms should not depend on a tax treaty being in force between the relevant jurisdictions. Where there is no tax treaty, an international set of rules should be applicable to ensure that following the international adoption of the "Unified Approach" taxpayers are able to resolve resulting double taxation.

- Below we outline our practical experiences with the three listed measures in question 7 and how these existing mechanisms should be altered and improved to adequately address the expected issues and disputes upon the introduction of the "Unified Approach".

2 (unilateral or multilateral) APAs

Advance Pricing Agreements (**APAs**) are an important tool for MNEs to obtain certainty in advance on their TP position. Historically this was mainly done through unilateral APAs, but bilateral or multilateral APAs have become more common due to the numerous cross-border elements in TP discussions of MNEs. The introduction of the “new taxing right” will increase the number of cross-border TP discussions and the potential for disputes. Due to the fact that the expected disputes will involve multiple jurisdictions, we will only address the multilateral APA as an efficient measure to avoid disputes under the “Unified Approach” and not a unilateral APA. A merely unilateral APA does not address these cross-border issues and still requires a MAP to solve any cross-border disputes that may arise (our experiences with the MAP are addressed in paragraph 4). The advantage of a multilateral APA is that potential issues and disputes can be resolved upfront to provide certainty to taxpayers and the jurisdictions involved on the tax position. In general we experience the following issues related to the bilateral/multilateral APA process that we expect are enhanced within the multilateral context of the “Unified Approach”:

– Uncertainty about access. This uncertainty follows from the competence of jurisdictions to accept or decline a multilateral APA request made by a taxpayer. For multilateral APAs to form an adequate mechanism, the “Unified Approach” should introduce rules to ensure that taxpayers will be entitled to obtain a multilateral APA without various prohibitive conditions. Merely relying on a cooperative attitude of jurisdictions will likely still result in many requests to be denied, so there needs to be a clear process to obtain a multilateral APA that would preferably be administered by the OECD.

– Duration. A multilateral APA can take a long time. A process of a few years is not uncommon. During this time, the taxpayer has no security about the outcome and will not be able to implement a new transaction or business opportunity with certainty on its tax position. The multilateral APA process under the “Unified Approach” needs to contain a clearly defined term during which agreement needs to be reached by the authorities involved in order to be effective.

– No obligation to reach a result. This leads to uncertainty for the taxpayer and linked with a long duration can result in a taxpayer having to start a MAP to resolve double taxation when the jurisdictions involved cannot come to an agreement. In some cases when following a lengthy multilateral APA process no agreement was reached, the taxpayer had to resort to a subsequent lengthy MAP procedure to resolve the double taxation that occurred during the duration of the APA process.

  For the multilateral APA to work as an effective dispute prevention mechanism for the “Unified Approach” there must be an obligation to reach a result within a defined term. This obligation to reach a result within this term prevents disputes and will avoid that

taxpayers have to resort to dispute resolution mechanisms afterwards or at least limit the timeframe of such disputes.

– Competence of national or local tax authorities. In some jurisdictions the local tax inspector is directly involved with the APA process and not a national institution. It is preferred that the competence for the multilateral APA procedure lies with a national institution and not with the local tax inspector, since these disputes on the "new taxing right" should be settled by jurisdictions in the same manner and not at the discretion of various local tax inspectors within a jurisdiction.

A final important remark on APAs is that under the "Unified Approach" it may not always be straightforward to identify which countries should agree to the multilateral APA. This is because jurisdictions may start taxing (under Amount A) the profits of entities that so far had no taxable nexus with these jurisdictions, and there is also not yet clarity on which entities of the MNE would see its profits subject to new taxing rights under Amount A. In view hereof we suggest that the OECD should play a role in the administration of this new APA process to ensure that there is clarity on the respective jurisdictions involved.

3 ICAP

The OECD International Compliance Assurance Program (**ICAP**) is currently entering its second pilot phase. The novelty of ICAP, the limited number of participating jurisdictions, combined with no legal certainty for MNEs under the program, would in our view not make this an adequate dispute prevention or resolution mechanism. Since we expect that the introduction of the "Unified Approach" results in many disputes between various jurisdictions, taxpayers want either certainty on the avoidance thereof or a resolution afterwards, which ICAP both currently does not seem to offer.

4 Mandatory binding MAP arbitration

Many MNEs choose a MAP when confronted with cross-border TP issues, mainly because of the negative impact a purely national legal procedure could have. Currently a MAP generally only contains a best-efforts obligation and not an obligation to achieve a result. Question 7 already indicates that in respect of the "Unified Approach" this should be mandatory binding MAP arbitration and not merely a best-efforts obligation. In general we noticed the following issues related to the MAP dispute resolution mechanism, where some are similar to those we listed for the multilateral APA due to the comparable process of the instruments:

– Uncertainty about access. This follows from the competence of jurisdictions to accept or decline a MAP request made by a taxpayer. Both the OECD model convention and the EU arbitration treaty state that a MAP can only be started when the requested jurisdiction has decided not to make an unilateral adjustment. However, they do not contain a defined term. We know that in practice some jurisdictions use this shortcoming to delay the MAP

or to actually block the access to a MAP. MAP as an effective dispute resolution mechanism for the "Unified Approach" needs to contain clear access for taxpayers that cannot easily be delayed or blocked by jurisdictions itself. We suggest that the OECD should administer and determine the MAP process in respect to the allocation of the allocable profit to the user/market jurisdictions, whereas the jurisdictions to which the profit is allocated based on the at arm's length principle should participate in the MAP procedure themselves. This should ensure that the access for taxpayers in all potentially involved jurisdictions under the "Unified Approach" is ensured.

– Duration. A MAP can take a long time, sometimes a few years. During this time the taxpayer has no security about the outcome and may be double taxed as long as there is not yet a result. MAP as an effective dispute resolution mechanism for the "Unified Approach" needs to contain a clearly defined term during which the process has to be resolved. In view of the number of disputes we expect due to the introduction of the "new taxing right", a term of less than a year would be preferred.

– No obligation to reach a result. This leads to uncertainty for taxpayers and double taxation may remain following the MAP. In some cases the MAP tax treaty article has a mandatory arbitration provision, which entails a result obligation. However, the lack of rules and defined procedure may then still result in no arbitration, as there are no defined terms within jurisdictions have to appoint the arbitrators. In practice we have seen cases where the arbitrators never get appointed and the arbitration procedure as such never starts.
In addition, we would like to point out that the mandatory binding arbitration as a dispute resolution mechanism, proved to be a bridge too far for most OECD member countries with respect to BEPS 14 and the MLI. Most were unwilling to commit to mandatory binding arbitration which leaves the question why they would be willing to commit now.

However, for MAPs to work as an effective dispute resolution mechanism under the "Unified Approach" there must be an obligation to reach a result within a defined term. The question has already been formulated in respect of mandatory binding MAP arbitration and this obligation to reach a result will be crucial to ensure the efficiency of this mechanism.

– Direct and indirect costs related to the MAP. Besides the fact that an assessment of the costs that are directly related to the MAP is nearly impossible, there are also indirect costs that cannot be foreseen. These indirect costs can be related to numerous causes, but tax interest may be most common. Such tax interest costs could arise when one jurisdiction imposes an additional tax assessment including tax interest, while the other jurisdiction does not compensate the tax interest imposed when providing relief of double taxation. This leads to additional (indirect) costs that simply cannot be foreseen.

MAP as an effective dispute resolution mechanism for the "Unified Approach" should address the cost element to ensure that taxpayers would not be unnecessarily burdened with excessive direct and indirect costs due to the significant number of disputes we expect upon the introduction of this "new taxing right".

To eliminate the tax interest cost we suggest that taxpayers pay the tax due over the highest contested amount under the respective MAP into a blocked account administered by the OECD[3], which account the jurisdictions cannot access until agreements has been reached under the MAP. In case the jurisdictions involved would reach an agreement that results in a lower amount of tax due by the taxpayer, interest should preferably be compensated over the to be refunded amount.

– Disruption of relationship local tax authorities. In some jurisdictions the local tax inspector is directly involved with the MAP and not a national institution. As a result, they may be hesitant to start a MAP as it leads in most cases to additional audits of the tax authorities involved influencing the relationship with the relevant tax authorities.

  We suggest that competence for the MAP on the allocable profit to the user/market jurisdictions should lie with the OECD, whereas for the allocation based on the at arm's length principle this should a national institution should be competent. No local tax inspector should be involved in these MAPs, since these disputes should be settled by the OECD and jurisdictions in the same manner and not at the discretion of various local tax inspectors within a jurisdiction.

– Blocking effect of national legal procedures. We know some EU Member States have constitutional provisions that prohibit them to deviate from a decision made by the national court. A MAP gives them a chance to further explain the decision, but as the jurisdiction involved is unable to deviate from the national court decision the extent to which the double taxation will remain is entirely dependent on the willingness of the other jurisdiction to follow this reasoning. Logically, the other jurisdiction may not always accept this outcome. In view hereof it is relevant that the MAP procedure that would be introduced as dispute resolution mechanism for the "Unified Approach" is mandatory and binding independent from respective local legislation to ensure double taxation is actually resolved.

As mentioned above, the possibility to have a MAP should not depend on a tax treaty being in force between the relevant jurisdictions. Where there is no tax treaty providing for a MAP, an international set of rules governing MAPs should be applicable to ensure that following the international adoption

[3] Such would be in line with paragraph 1.98 of the 2017 OECD TP Guidelines.

of the “Unified Approach” taxpayers are not faced with double taxation and are able to resolve these situations.

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