ITI Promoting Innovation Worldwide

Comments on the draft OECD/G20 Inclusive Framework Pillar One Multilateral Convention Text

December 8, 2023

The Information Technology Industry Council (ITI) appreciates the opportunity to respond to the U.S. Department of the Treasury's request for public input on the draft OECD/G20 Inclusive Framework (IF) Multilateral Convention to Implement Amount A of Pillar One (MLC) and accompanying documents.[1]

The proliferation of digital services taxes (DSTs) and other problematic unilateral tax measures has destabilized the international tax system and led to challenges for all industries that do business across borders. As the IF has long maintained (and ITI agrees), it would not be feasible to ring-fence the digital economy for taxation purposes "because the digital economy is increasingly becoming the economy itself."[2] Global tax policy challenges require principles-based global tax policy solutions that engender stability, certainty, and predictability in the international tax system.

ITI views the IF as the best-positioned venue to address the tax challenges arising from the digitalization of the global economy, and ITI and its members are committed to supporting the IF's efforts to make for a multilateral, consensus-based solution to those challenges. Over the years, ITI has contributed to the IF's work by developing consultation responses to negotiators' questions and proposals, participating in public meetings, and publishing principles to guide negotiators as they undertake significant reforms to the international tax system. The draft MLC's release in October 2023 marked the first time that taxpayers and other stakeholders could review the draft package in its entirety; for that reason, the global technology industry greatly appreciates Treasury's holding a public consultation on the package.

In light of alternatives, ITI sees potential in the draft MLC for developing a multilateral, consensus-based framework to alleviate the negative consequences of the increasingly fragmented and controversy-heavy international tax environment. That is why ITI encourages Treasury to remain deeply engaged in the IF; absent strong U.S. participation, there is little chance of resolving outstanding issues and making for a final product that provides certainty and predictability for the global technology industry. For Pillar One to be

[1] The Information Technology Industry Council (ITI) is the premier global advocate for technology, representing the world's most innovative companies. Founded in 1916, ITI is an international trade association with a team of professionals on four continents. We promote public policies and industry standards that advance competition and innovation worldwide. Our diverse membership and expert staff provide policymakers the broadest perspective and thought leadership from technology, hardware, software, services, and related industries.

[2] OECD, "Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report," October 2015, 54.

successful, U.S. Treasury and partners must also commit to supporting capacity building in participating tax administrations.

We put forward the following Pillar One-related priorities and objectives to guide Treasury's engagement in the IF and contribute to its future consideration of an MLC. The remainder of the comment identifies several implementation and administration issues in the MLC that would benefit from further consideration.

Key areas for Treasury to focus its attention include:

- **Improve and complete the MLC.** The comment goes into more detail, but ITI draws particular attention to achieving better balance between administrability and precision in the revenue sourcing rules, providing more double taxation relief through the marketing and distribution profits safe harbor (MDSH), clarifying that a measure can be a DST or relevant similar measure (RSM) if the scoping and/or burden of collections primarily falls on non-resident taxpayers, making clear that Significant Economic Presence (SEP) measures are not appropriate for any taxpayer, and strengthening Contracting Parties' commitment with respect to subnational taxes. ITI encourages the IF to further consider an enforcement mechanism to ensure the standstill and rollback of DSTs and RSMs occurs. We also note with concern the outstanding issues in the MDSH section, as these issues have significant bearing on the overall effectiveness of Amount A.

- **Extend the standstill.** ITI strongly supports extending the standstill on the imposition of DSTs and RSMs, as it provides for a more stable tax environment in the interim and reduces the risk of perverse incentives that may derail finalization of the project. U.S. Treasury should continue pushing for the IF to provide an explicit extension of the standstill through the earlier of December 31, 2025 (to provide sufficient time for the IF to achieve consensus on all material aspects of the MLC) or the coming into force of the MLC.

- **Dissuade the Canadian government from adopting a DST.** Despite significant milestones in the IF, the Canadian government continues to reiterate its interest in advancing a DST. ITI continues to call on U.S. Treasury and U.S. interagency partners to encourage the Canadian government to fully drop its consideration of a DST and respect its commitment to realizing a multilateral, consensus-based solution through the IF.

- **Finalize Amount B and commit to expanding initial scoping.** ITI continues to appreciate the U.S. emphasis on the need for a robust Amount B to fulfill the Pillar One package. Amount B has a critical role to play in securing tax certainty and facilitating a more predictable and stable international tax landscape, which is why the U.S. and other IF jurisdictions should finalize Amount B before the end of 2023.

ITI seeks a commitment from U.S. Treasury to exploring ways to expand Amount B's coverage, particularly for services and intangible goods and services.

- **Confirm the treatment of Pillar One taxation for the purposes of Pillar Two.** The Commentary to the Global Anti-Base Erosion (GloBE) Model Rules supports the application of Amount A before the GloBE Rules and the alignment of market jurisdiction tax with related GloBE Income but also foreshadows the development of further administrative guidance to address the treatment of Pillar One taxation.[3] U.S. Treasury should work with the IF to prioritize developing administrative guidance to make clear the treatment of Pillar One taxation for the purposes of Pillar Two.

Again, ITI appreciates the work that the U.S. Treasury and other IF participants have put forward and the opportunity to provide commentary on the draft comprehensive package.

Novel Issues Identified by a Review of the Comprehensive Text

Annex B – Calculation of Adjusted Profit Before Tax

The Elimination Profit (Annex B, Section 4.2) incorporates tax stock-based compensation (SBC) but the Adjusted Profit Before Tax (Annex B, Section 2.1) does not consider tax SBC. The MLC nor the Explanatory Statement (ES) provide an explanation for the discrepancy. ITI requests that the calculation of Adjusted Profits Before Tax be amended to include tax SBC so that it aligns with the calculation for Elimination Profit.

Implementation and Administrability Issues

Article 2 – General Definitions

Lower Income Jurisdiction. Article 2(dd) defines "Lower Income Jurisdiction" as a Jurisdiction that the World Bank identifies as a low-income economy or as a lower-middle-income economy as measured by gross national income per capita by the World Bank Atlas method. However, the World Bank does not assess all jurisdictions participating in the IF.[4] U.S. Treasury should seek guidance on ways to identify a Jurisdiction as a "Lower Income Jurisdiction" if that Jurisdiction has not been assessed by the World Bank Atlas method.

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[3] GloBE Model Rules Commentary on Article 4.2 at paragraph 29: "Tax on net income of a Constituent Entity under Pillar One would be treated as a Covered Tax under the GloBE Rules as a tax with respect to income or profits. Because Pillar One applies before the GloBE Rules, any income tax with respect to Pillar One adjustments will be taken into account by the Constituent Entity that takes into account the income associated with such Tax for purposes of calculating its GloBE Income or Loss."

[4] As of November 13, 2023, Jurisdictions participating in the IF but not represented in the World Bank's assessment of gross national income (GNI) per capita, Atlas method include Anguilla, British Virgin Islands, Cook Islands, Gibraltar, Jersey, and Montserrat.

Annex C – Supplementary Provisions for Article 3 (Covered Group)

Section 3 of Annex C would require Covered Groups subject to segmentation to calculate Amount A as a Segment in year 2 – rather than as a Covered Group in year 2, even if it meets the profit threshold for being in-scope as a Covered Group in year 2 – to the extent that (i) in year 1, the Segment meets the profit threshold but not the Covered Group; and (ii) the calculation of Amount A as a Segment in year 2 would result in additional Amount A reallocation than if computed for the entire Covered Group.

ITI recommends revising the MLC to disregard the segmentation approach in year 2 if the Covered Group is otherwise in scope of Amount A, as there is no policy basis for calculating Amount A on a segment basis if the Covered Group is in scope. If the provision remains, then there should be a corresponding provision that reduces the Amount A allocation for the year following that in which a Covered Group falls out of scope.

Article 5 – Allocation of Profit Associated with Revenues in the Market

Article 5.1(b) enables the application of the MDSH adjustment if the adjusted elimination profit (or loss) of the Covered Group in the Jurisdiction for the Period is greater than or equal to EUR 50 million. A Covered Group is considered as having nexus in a Jurisdiction for a Period if Adjusted Revenues arising in that Jurisdiction are equal to EUR 1 million or EUR 250 000 for a Jurisdiction with a Gross Domestic Product of less than EUR 40 billion. The considerable gap between the initiation of nexus and the application of the MDSH adjustment limits the effectiveness of the MDSH, as the MDSH will not be available in many jurisdictions and Covered Groups will bear a significant compliance burden. ITI suggests that the IF remove thresholds altogether for the application of the MDSH or, at a minimum, establish the same threshold for receiving an Amount A allocation and benefitting from MDSH, or apply a threshold for the MDSH that is more proportionate to the thresholds for nexus.

Article 5(d) establishes the conditions to determine the "jurisdictional offset percentage" in a Jurisdiction. The business community continues to view the "jurisdictional offset percentage" as undermining the effectiveness and guiding principles behind the MDSH and recommends that the jurisdictional offset percentage be eliminated or set at 100% in all cases. ITI further urges for Amount A to be adjusted for 100% of the Withholding Tax paid in the Jurisdiction.

ITI welcomes the inclusion of a mechanism to account for Withholding Tax(es) imposed by a Market Jurisdiction to reduce Amount A allocation to that Market Jurisdiction. However, the number of unresolved issues related to Withholding Taxes is concerning given the importance of double taxation relief. ITI also notes with concern there will be no adjustment for the first two years following implementation of the MLC, and that in following years the adjustment will fall to between 25% and 85% of the WHT suffered. A robust MDSH – which includes Withholding Taxes in a meaningful way – is critically important to a successful Amount A.

Article 6 – Sources of Adjusted Revenue

ITI appreciates the IF's revisions to make the sourcing rules more administrable, particularly through clarifying the predominant character rules and setting the expectation that taxpayers rely on commercial and other available data rather than pursue novel reporting obligations. However, there are still scenarios where taxpayers may not have data for enumerated reliable indicators. ITI encourages the IF to produce principles and/or examples that demonstrate how taxpayers should navigate situations in the absence of enumerated reliable indicators. This would make for a smoother process for taxpayers who work with Advance Certainty Panels to devise compliance processes that reflect these principles and make use of available data.

Enterprise-application software. Article 7.1(d)(ix) prescribes that "not described" services are treated as arising in the Jurisdiction in which the service is used. This section attempts to apply a single source rule to significantly different fact patterns, some of which may benefit from greater clarity. In particular, the sourcing principle does not aid in identifying a reliable method to determine the appropriate Jurisdiction for revenues arising from the provision of enterprise-application software (EAS).

The MLC should clarify that EAS should be considered as used in the Jurisdiction of the direct purchasing entity, which for all intents and purposes is the user of the software or its final customer. EAS facilitates central business management functions and mission-critical operations for an organization, which allows the business to centrally manage organizational data from various sources to improve efficiency and productivity. The expense to purchase, maintain, and operate EAS is borne by the purchasing entity responsible for implementing the solutions. Similarly, the core advantages of the EAS principally benefit the direct purchasing entity. The revenue sourcing rules should reflect the realities of EAS by explicitly identifying the end-user or final customer of EAS as the purchasing entity which incurs the expense and the associated benefits. For this category, sourcing by billing address is appropriate to determine the Jurisdiction of use for both specified large customers (SLCs) and non-SLC customers. This approach would be consistent with treatment under current Treasury and IRS regulations.

Other Services (including cloud service providers). With regard to "specified large customer," ITI welcomes the removal of requirements for service providers to request additional data from its customers. The revised rules still present a challenge for cloud service providers due to the requirement for businesses to apply different allocation methods by customer type (Small Customers, Large Customers, and Resellers). For example, the imposition of three different sourcing rules will require Covered Groups to separate revenues between direct sellers (and differentiate by size) and resellers. Further complicating the task is that some direct customers are also resellers, which may make differentiating more difficult if not impossible.

ITI recommends instead that determining the top 200 Large Customers based on individual account numbers where no additional information is readily available, be considered a

reasonable method. The MLC should also affirm that customers can use the same allocation key method for all three customer types where the relevant information to segregate by customer type is not readily available.

Using the headcount allocation for a Large Customer would require a taxpayer to segregate their customers into a subset of Large Customers and obtain customer-specific information on headquarter locations (which may not be public information), and then determine the appropriate allocation key. The subjective standard for a seller to satisfy reasonable efforts to demonstrate it does not have an undefined "client file" in its possession or has searched for "accessible" information sources creates uncertainty and undue burden.

Article 12 – Provision of Relief for Amount A Taxation to Relief Entities

As drafted, the MLC allows for significant flexibility in domestic laws that may yield double taxation. One example is the rules set a minimum of three years for credit carryforwards but do not articulate what happens if the relief is not achieved in three fiscal years. ITI recommends making credit carryforwards indefinite until the relief is achieved. Further, the IF should make clear that jurisdictions cannot deny other double tax relief as a result of relief being granted under the MLC.

Industry has consistently called for the exemption method as the only means of eliminating double taxation and maintains that position in the response to the MLC.

Article 21 – Currency Conversion Rules for Calculations and Liabilities

Article 21.3(b) provides a Party with the discretion to rebase local currency thresholds based on the average foreign exchange rate as quoted by the Party's central bank "if the Party faces legal or practical impediments" to using the foreign exchange reference rates quoted by the European Central Bank. This discretion presents the possibility of a dispute over thresholds. ITI suggests the development of a default rule governing conversion rate to address any potential disputes over thresholds resulting from the flexibility in Article 21.3(b) and provide greater certainty and clarity for taxpayers.

Article 22 – Requests for Certainty over Whether a Group is a Covered Group

Article 22.1 introduces a "tax certainty user fee" to accompany a Group's request for scope certainty for a Period.[5] Any such user fee should be reasonable and not unduly burdensome. The IF should also consider a mechanism to coordinate reviews in order to address several issues at once and minimize the imposition of the user fee on an issue-by-issue basis.

Article 27 – Determination Panel to Resolve Disagreements

The alternative outcomes provided to a determination panel should include the compliance approach identified by the Covered Group. ITI recommends amending Article 27.2 to ensure

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[5] Article 23.1 introduces a "tax certainty user fee" for the purpose of submitting a Covered Group's request for comprehensive certainty and a Covered Group's request for advance certainty. The comments on Article 22.1 apply equally to the applicable "tax certainty user fee" for comprehensive certainty and advance certainty.

the Covered Group's compliance approach receives consideration alongside the other alternative options.

Article 33 – Mutual Agreement Procedure

The MLC does not directly address tax certainty for issues related to Amount A in the absence of a covered tax agreement. To achieve greater stability for issues related to Amount A, ITI encourages the IF to adopt language in the MLC that directs covered jurisdictions and Covered Groups to follow transfer pricing guidelines (e.g., the OECD Transfer Pricing Guidelines) if a covered tax agreement is not in effect. This will be especially important for taxpayers that will not benefit from the limited scope of Amount B as currently drafted. Relatedly, ITI underscores again the importance of expanding Amount B to include services.

Article 35 – Resolution of Disputes with Respect to Related Issues

ITI welcomes the revisions to the provisions on mandatory dispute resolution, such as the expansion of "matters related to Amount A" to include Transfer Pricing, Permanent Establishment, and Withholding Tax disputes.

Article 37 – Exchange of Information and International Cooperation

The MLC requires significantly more data for calculations than is currently required for tax compliance and cautions against using data for "fishing [expeditions]." Given the greater level of detail and therefore heightened sensitivity, ITI recommends that U.S. Treasury advocate for more tangible guardrails around the use of "foreseeably relevant" as justification for sharing data, as well as advocate for establishing rules to address breaches of confidentiality. Participating jurisdictions have substantive variations in legal obligations for protecting taxpayers' information, so it would be useful to have an IF-wide understanding of the responsibilities arising from data related to Amount A compliance. Further, it is not clear why the MLC seems to consider "tax policy analysis" as a reasonable justification for sharing data; ITI recommends removing that justification.

Part VI – Treatment of Specific Measures Enacted by Parties

ITI strongly welcomes the removal of existing DSTs and RSMs and the development of criteria to prohibit the future imposition of such measures. The current draft includes significant improvements compared to the language previously published in December 2022.

The MLC does not include an enforcement mechanism for the standstill and rollback of DSTs and relevant similar measures. The carrot for withdrawing a DST is receiving Amount A taxing rights; however, there is no stick that recognizes the harmful effects of DSTs to the overall international tax and trade environment and encourages jurisdictions to roll back their DSTs. ITI encourages the IF to further consider an enforcement mechanism to ensure the standstill and rollback of DSTs and relevant similar measures takes place.

Article 38 – Removal of Digital Services Taxes and Relevant Similar Measures

ITI appreciates the IF's continued commitment to prohibiting the application of DSTs and RSMs to any person.

Article 39 – Elimination of Amount A Allocations for Parties Imposing Digital Services Taxes and Relevant Similar Measures

When determining whether a measure is a DST or RSM, Article 39.2(b)(ii)(A) establishes one factor as the presence of "revenue thresholds, exemptions for taxpayers subject to domestic corporate tax in that Party, or other scope restrictions that cause the measure to apply in practice **exclusively or almost exclusively** to non-resident or foreign-owned businesses" (emphasis ITI). The ES includes an example where "only a few percent of the taxpayers" were domestic taxpayers. While recognizing this is one example, ITI considers the current interpretation of "exclusively or almost exclusively" to be too narrow and strongly encourages the IF to clarify that a measure can be a DST or relevant similar measure if the scoping and/or burden of collections primarily falls on non-resident taxpayers. A small domestic incidence of an otherwise targeted tax should not absolve that Party of its commitments under Part VI of the MLC.

ITI also raises concern about Article 39.2(b)(ii)(B)'s standard of "[having] the effect of insulating domestic businesses from the application" and the accompanying statement that the evaluation of a measure will take into account the "policy objectives of the tax." The application of such a subjective test may enable the continued introduction of discriminatory measures under the guise of other "policy objectives" and yield the same destabilizing effects. ITI recommends either removing the third prong altogether or establishing guardrails to ensure that consideration of "policy objectives" does not become a carte blanche.

ES paragraph 918 makes clear that Amount A would be denied starting on or after the date of a decision by the Conference of the Parties, "and not retroactively." ITI firmly believes that Amount A should be denied from the date such a law takes effect. The imposition of a DST throughout the determination process creates contrary incentives because the negative consequences for the jurisdiction will be delayed but the DST will have an immediate effect on affected taxpayers. The MLC should require full repayment of the DST amounts; at a minimum, the DST liability should remain creditable against any Amount A owned to that Party.

The United States' existing transitional arrangements with several jurisdictions enable taxpayers to obtain a credit against Amount A liability for DSTs paid in the interim period. ITI suggests that the IF modify the MLC to incorporate a credit with respect to DSTs paid during the interim period and extend affected taxpayers the opportunity to obtain a credit against Amount A liability with respect to DSTs paid until the MLC takes effect and the third jurisdiction ceases to impose the DST.

Annex H – Review Process and Early Clarification on Digital Services Taxes and Relevant Similar Measures

Annex H of the MLC provides that if a subnational jurisdiction in a Party imposes a "subnational digital services tax or relevant similar measure," the Party in which the subnational entity is located must report to the Conference of the Parties within six months to "detail its efforts to achieve the removal of the measure." There is no denial of Amount A

reallocation (or even a requirement for a Party to take any action) for a Party in which a subnational government imposes a DST or RSM. Absent a denial of Amount A reallocation, little stands in the way of a proliferation of subnational DSTs and RSMs that stand to disrupt the international tax system. ITI strongly encourages the IF to act to prevent the proliferation of subnational measures and alleviate the effect of any subnational measures.

Article 40 – Treatment of specific measures in scope of tax treaties

Article 40 would prevent Parties from applying certain measures in scope of tax treaties (e.g., SEP measures or similar concepts) to Group Entities of Covered Groups and that "[revenue] will not be included in the Elimination Profit (or Loss) of Amount A." ITI supports the non-imposition of SEP measures or similar concepts to Covered Groups but has concerns that the MLC may inadvertently imply that SEP measures or similar concepts are appropriate for MNEs that are not Covered Groups. The MLC or the Explanatory Statement should make clear that the IF does not endorse SEP measures or similar concepts, and that the IF firmly opposes the proliferation of such taxes.

ITI understands the SEP measures and similar concepts to sit outside of the Conference of the Parties' process for determining DSTs and RSMs. If a Party imposes a SEP measure or similar concept on a Covered Group, then the Covered Group only has recourse through that Party's domestic legal system. ITI urges the IF to consider establishing penalties for Parties that impose SEPs or similar concepts on Covered Groups.

Similar to DSTs and RSMs, SEP measures have a destabilizing effect on the international tax environment by imposing uncoordinated, gross revenue-based taxation and attempting to ring-fence the digitalizing economy. SEP measures or similar concepts establish corporate tax liability in a jurisdiction around the basis of sales and/or market engagement rather than permanent establishment, which conflicts with the international tax system's generally assigning taxing rights around the concept of permanent establishment. Governments are unlikely to provide a credit for any SEP tax paid, and companies can incur significant compliance costs in addition to payment of the tax itself. The approach is burdensome for all companies but is especially impactful for low-margin and loss-making companies; the structure also means that the burden of the tax frequently falls on in-country business-to-business and business-to-consumer sellers and consumers through price increases.

Conclusion

ITI thanks Treasury for its years of engagement and contributions across several administrations to the IF's efforts to address the tax challenges arising from the digitalization of the global economy. We stand ready to answer any questions you may have on the comment.

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