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December 11, 2023

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and submitted electronically to OTP_Pillar1MLC@treasury.gov

Re: Draft OECD/G20 Inclusive Framework Multilateral Convention to Implement Amount A of Pillar One

Dear Assistant Secretary Batchelder and Deputy Assistant Secretary Plowgian:

We are pleased to submit comments on behalf of the Digital Economy Group (the **"DEG"**), an informal coalition of leading United States and European companies which provide digital goods and services to global customers. We appreciate the opportunity to provide input on the draft OECD/G20 Inclusive Framework (**"IF"**) Multilateral Convention to Implement Amount A of Pillar One (the **"Draft MLC"**) published on October 11, 2023.

The DEG appreciates the recent comments from Treasury officials that Treasury is particularly interested to receive comments from stakeholders with respect to whether the Draft MLC achieves the goal of stabilizing the international tax framework. Our comments will focus on that aspect of the Draft MLC.

DEG members include many of the largest payers of digital services taxes (**"DSTs"**) and of other taxes imposed under other recent unilateral measures that have targeted the digital economy. DEG members therefore have a uniquely relevant understanding of these measures, the legislative intent behind such taxes, their recent evolution, the political pressures that have led to their proliferation, and their destabilizing effect on the international tax framework. The DEG has closely observed the development of the proposed multilateral agreement at the heart of Pillar One, namely that market jurisdictions will be granted a new, standardized taxing right under Amount A in exchange for both the removal of current DSTs and relevant similar measures and the commitment to not introduce similar measures in the future. This compromise is intended to re-stabilize the international tax framework by increasing certainty, removing unilateral actions to tax the profits of nonresident digital service providers outside of existing norms, and preventing future deviations from international tax norms.

As we have previously commented during the OECD/IF consultation process, establishing a definition of DSTs and relevant similar measures that effectively identifies destabilizing unilateral measures and contemplates potential future measures is essential in order to fulfil Treasury's goal to stabilize the international tax system. Our comments therefore focus on the

definition of DSTs and relevant similar measures in Article 39 of the Draft MLC, as well as the related provisions in Article 38, Article 40, Annex A and Annex H.

We also provide comments on Amount B. We acknowledge that Amount B is not covered by the Draft MLC. Amount B is nonetheless a very important component of Pillar One. We understand that work continues to refine Amount B, which aims to facilitate compliance and reduce disputes relating to the remuneration of related party distributors that perform baseline marketing and distribution activities in a manner that is aligned with the arm's length principle. The DEG sees Amount B as a critical part of the overall goal of Pillar One to stabilize the international tax system. We were therefore encouraged by recent comments from Treasury officials that emphasized the need for a robust Amount B in order to reach agreement with respect to Amount A.

As will be discussed further herein, the DEG makes the following recommendations:

- The second element of the *de facto* discrimination test in Article 39(2)(b)(ii)(B) should be eliminated. This element is largely duplicative of the first element in terms of intent, and appears to create a stricter standard that allows a tested tax to escape sanction even if it clearly applies almost exclusively to nonresidents.

- The standard for determining whether a measure applies "almost exclusively" to nonresidents should be revised to acknowledge the actual application of existing DSTs. The Explanatory Statement provides that a measure will be considered to apply "almost exclusively" to nonresidents or foreign-owned businesses if only a "few percent" of all taxpayers were domestic businesses. This example applies a far too narrow interpretation, as it could be interpreted to suggest that even a measure which the legislature clearly has targeted at non-residents may be considered non-discriminatory, if more than a mere "few" percent of total taxpayers are domestic. Such a narrow definition might not even describe some DSTs in existence today.

- A better comparative measure to define discrimination would be to apply the comparison based on the relative tax revenue collected from nonresidents. The language in the Explanatory Statement could be revised to implement a tax revenue comparison test.

- In light of the difficulties of designing a numerical test to define discrimination, Article 39(2)(b)(ii) or the Explanatory Statement should provide that *de facto* discrimination exists when the legislative intent is to impose the tax principally on nonresident digital service suppliers.

- The flush language in Article 39(2)(b)(ii) should either be modified, or it should be deleted. The most appropriate modification would be revise the flush language to provide that if a measure satisfies the first and third requirements in Articles 39(2)(a) and 39(2)(c), and the tax was imposed for a significant purpose of taxing the profits of nonresident digital service providers, the measure will satisfy the discrimination

requirement in Article 39(2)(b). If this modification is not made, the flush language should be deleted.

- Article 39(2)(c) should include an exception that provides that the requirement will not apply as an element of the definition of a DST or relevant similar measure if the measure is intended to apply exclusively or principally to the business sector of digital service suppliers. This element of the draft definition results in withholding taxes on payments for the provision of digital services escaping the definition of DSTs and relevant similar measures. The definition certainly should capture such clearly discriminatory and destabilizing measures.

- The "artificial structuring" exception of Article 39(3)(a) should be based on abuse of law principles, rather than on a highly ambiguous and novel "artificial structuring" concept.

- If the "artificial structuring" exclusion remains in the MLC, we recommend that any measure that is proposed to be excepted on the grounds that it protects against "artificial structuring" undergo review by a panel process similar to the review processes established in Annex H.

- Any measures that are allowed to continue under the exemption in Article 39(3)(a) should be accounted for in the Amount A calculation as a tax collected by the market state for purposes of the Marketing and Distribution Profits Safe Harbor.

- We strongly recommend that the preclusion in Article 40 for significant economic presence (**"SEP"**) rules be expanded to all taxpayers, not just Amount A taxpayers.

- Measures that would be captured by Article 40 should be added to Annex A. Such measures should be subject to review under the process established in Annex H.

- At least for parties that join the MLC within a few years of when the MLC is open for signature, the removal of measures listed on Annex A should align with the entry into force of the Convention once the critical mass has been achieved.

- We strongly recommend that all IF members extend the standstill and rollback agreement to allow for the signature and ratification process to proceed under more stable circumstances.

- Annex A should include certain additional measures, such as subnational DSTs or similar taxes, various European digital content taxes that are intended to discriminate against nonresident digital service providers, and existing SEP nexus rules that would be precluded under Article 40.

- The review process by the Conference of the Parties in Annex H should be replaced with a Panel Review Process similar to those proposed in the Amount A Tax Certainty rules. Alternatively, the *ad hoc* process described in paragraphs 7 and 8 of Annex H could be established as the principal forum in which to address these issues.

- The IF should provide more guidance as to what is expected of a Party with respect to subnational DSTs and relevant similar measures enacted in its jurisdiction, and establish relief measures for taxpayers subject to such taxes in cases of prolonged noncompliance by the subnational jurisdiction.

Background to the Draft MLC - the BEPS Project and its Aftermath

DEG members appreciate recent comments by Treasury officials that the Draft MLC should be assessed based on whether it is effective to restabilize the international tax framework. DEG members also appreciate Treasury's clear and public opposition to the various novel unilateral measures intended to tax the profits of nonresident suppliers of digital services which have been enacted by various countries in recent years. The Draft MLC is the only international instrument now under consideration that seeks to respond to these unilateral measures. The DEG therefore wishes to place the Draft MLC in context by noting its antecedents in the OECD/IF BEPS project and the reactions of some countries to the work of the BEPS Project by enacting unilateral measures such as DSTs.

The OECD/G20 BEPS Project initiated in 2013 resulted in major improvements to the international tax architecture. Proposals to neutralize the effect of hybrid mismatch arrangements, work to limit harmful tax practices, modifications to the OECD transfer pricing guidelines, improvements to dispute resolution mechanisms, the introduction of country-by-country reporting, and the other outcomes of the BEPS Project are all important contributions to a more stable and predictable international tax framework. Notably, these important developments were all agreed as part of the unified response to developments in the global economy, including the digitalization of all sectors and how that digitalization has facilitated cross-border trade in goods and services.

The work under Action 1, addressing the tax challenges of the digitalized economy, reached important conclusions on a consensus basis which provide important background to the Draft MLC and this request for public input. The Action 1 Final Report[1] thoroughly described business models which have been enabled or enhanced through the adoption of information and communication technologies. The Final Report noted that while such information technologies have enabled some new business models, they also have allowed enterprises operating in traditional sectors to become more efficient and reach more customers through cross-border communication efficiencies. The Final Report explored various discussion points related to digital economy business models to assess whether those points would be relevant for purposes of revising international tax norms on a consensus basis. For example, the Final Report noted that the potential of digital technologies to facilitate cross-border sales led to questions by some jurisdictions as to whether the current rules to determine direct tax nexus with a jurisdiction should be revised. The Final Report further noted that the growth in sophistication of information technologies has permitted companies in the digital economy to

[1] OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. ("Action 1 Final Report").

gather and use information across borders, raising the question of whether that ability has significance for tax policy. The Final Report then explored various conceivable changes to the generally prevailing nexus and profit attribution norms of international taxation.

Based on that thorough background discussion, the Final Report reached several important conclusions on a consensus basis, including the following.

- as a matter of international tax policy, it is not possible to ring-fence the digital economy;
- several of the changes adopted in the BEPS Project will address and mitigate many of the issues raised regarding the tax challenges of the digital economy, including the changes to the permanent establishment (**"PE"**) standard adopted as part of the work on Action 7, and the changes to the Transfer Pricing Guidelines adopted as part of Actions 8 - 10;
- countries were encouraged to consider the adoption of consumption tax collection and payment obligations for cross-border B2C sales by nonresident suppliers to local consumers. These extraterritorial collection and payment obligations now are in force in a very large number of countries around the world;
- none of the direct tax law changes discussed in the Final Report were recommended at that point. The Final Report observed that the measures developed in the BEPS Project and now adopted by many countries were expected to have a substantial mitigating impact on BEPS issues identified in the digital economy, and that consumption taxes will be levied effectively in market countries; and
- countries could, however, introduce other options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties.[2]

As the Action 1 Final Report predicted, the adoption of the BEPS Project proposals did materially affect the tax obligations of major multinational enterprises, including those operating highly digitalized business models. Structures which were based on asset ownership (both IP and tangible assets) without more were abandoned, and changes to the transfer pricing guidelines have had a material effect on the balance of profit attribution between market and supplier states.

It quickly became apparent, however, that some countries were not satisfied with the results of the Action 1 Final Report. Even though businesses were still in the process of implementing the BEPS Project changes, some countries concluded they would act immediately and unilaterally, before the concrete results of the BEPS Project changes became apparent. Some countries introduced tax measures or took interpretative positions expressly intended to impose greater market state tax liability for groups operating certain of the

[2] Action 1 Final Report, pp 136 - 137.

business models described in the Action 1 Final Report. In many, if not all, cases, those measures were novel in the international tax framework, and were imposed unilaterally without regard to existing norms of source and residence state taxation. In the most remarkable development, many of the taxes were engineered to fall outside existing tax and trade treaty obligations, despite the clear admonition in the Action 1 Final Report that any unilateral measure should be consistent with the taxing state's treaty obligations.

These unilateral measures took several forms, including digital services taxes,[3] significant economic or digital presence nexus rules triggered by digital or other transactions with customers as opposed to physical presence,[4] and assertions of extraterritorial nexus on the basis of PE avoidance theories.[5] In some cases, proposals have been advanced that expressly ring-fence transactions by highly digitalized enterprises.[6] In general, these measures exhibit one or more of four categories of destabilizing features: (1) targeting the business sector of digital services suppliers; (2) falling outside the scope of bilateral tax treaties; (3) creating alternative nexus standards that deviate from the standard set forth in Article 5 of the OECD Model Tax Convention on Income and on Capital (2017) (the **"OECD Model"**); and (4) applying withholding taxes to gross income derived from the provision of digital services.

We suggest that Treasury's reflections on whether the current definition of DSTs and relevant similar measures in the Draft MLC should be informed by this background. We appreciate that the Draft MLC reflects an effort to make the definition as objective as possible. As noted in our comments below, however, it is difficult to translate these features of destabilizing taxes into a test which is solely objective. Accordingly, we suggest how the proposed test could be made more effective and realistic in various places to acknowledge the legislative intent behind these unilateral measures, which has been to allocate a portion of the tax base of digital service providers to the market state.

To that point, we note that the introduction of the flush text into Article 39(2)(b)(ii) demonstrates that IF members in fact are willing to accept a review of the policy reasons for a tax to determine whether the tax meets the definition of a DST or relevant similar measure. If a policy assessment will be part of the rules, that policy assessment should allow the definition to cover taxes that exhibit the destabilizing features discussed below.

Targeting of Nonresident Digital Services Suppliers

As noted, the unilateral measures enacted in the wake of the BEPS project were enacted to apply specifically to digital services suppliers, despite the conclusion under Action 1 that the digital economy should not be ring-fenced. These taxes generally are targeted taxes based on

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[3] *See, e.g.* European Commission, Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenue Resulting From the Provision of Certain Digital Services (March 21, 2018).
[4] *See, e.g.,* Nigeria Companies Income Tax (Significant Economic Presence) Order (February 10, 2020); Colombia Significant Economic Presence rule, Article 57 of Law No. 2277, "Por Medio de la Cual se Adopta una Reforma Tributaria para la Igualdad y la Justicia Social y se Dictan Otras Disposiciones".
[5] *See, e.g.*, UK Diverted Profits Tax (Finance Act of 2015, C. 11, Part 3).
[6] *See, e.g.*, Article 12B of the UN Model Tax Convention, as agreed by the Committee of Experts at its 22nd Session.

a defined type of income or business model. Furthermore, these taxes normally are designed to reach principally nonresidents through scope or threshold definitions. The early European DSTs are examples of this type of tax, as are some of the European taxes imposed on the supply of digital content.

These taxes destabilize the international tax framework because they create a discriminatory set of rules specific to an industry. The clear legislative intent is to bring the tax base of nonresident digital service suppliers into the market state. This discriminatory legislative intent based on a business sector is a clear destabilizing action.

Amount A and the Draft MLC reflect the agreement amongst IF members that changes to the nexus rules to allow limited taxation of nonresidents should be applied broadly, rather than by ring-fencing a particular sector of the economy.

Evading Tax Treaties

Another concerning trait of some unilateral measures is the evasion of existing bilateral tax treaties. Legislators have endeavored to place taxes outside the scope of all existing international tax and trade agreements, so that the imposition of the tax on cross-border transactions could be imposed on a strictly unilateral basis. For example, a taxing state tax administration may assert that a tested tax is outside the scope of the Covered Taxes articles of its bilateral tax treaties, and is not clearly a VAT or similar indirect tax whose cost is borne by consumers.

A taxing state assertion that the tested tax is not covered by its in-force bilateral tax treaties on its face creates instability in the international tax system. Designing direct tax legislation to fall outside the scope of tax treaties erodes the certainty that bilateral tax agreements provide to taxpayers and undermines confidence in multinational agreements. This also prevents taxpayers from accessing the dispute resolution mechanisms in the relevant treaty to resolve conflicts regarding the unilateral measure. Any tax which exhibits this feature is antithetical to stabilizing the international tax framework. We certainly agree with the Draft MLC text that this element clearly is destabilizing, but we also note that not all destabilizing taxes include this element.

Creating Alternative Nexus Standards

The PE rules in Article 5 of the OECD Model reflect an agreed approach to allocating taxation rights based on accepted understandings of how enterprises create value. Nexus rules based on physical activity conducted through a fixed place of business or agent activity acknowledges the economic point that value is created by the personnel and assets deployed by the enterprise. When it becomes necessary to allocate that value between jurisdictions, the allocation between the various value creating activities is determined by the arm's length standard. The BEPS project and the resulting Multilateral Instrument (**"MLI"**) contained some revisions to the definition of what value creating activity constitutes taxable nexus. The revisions were intended to reform the rules for the modern economy.

Most of the unilateral measures went far beyond the changes agreed to the nexus standard in the BEPS project and explicitly adopted market-based criteria to determine nexus. This is most clearly expressed in the SEP rules, which create nexus based on income derived by nonresidents from transactions with customers in the jurisdiction. DSTs also have this as an underlying principle, as the purpose of DSTs was to bring a nonresident digital service supplier's tax base into the taxing state solely by reference to the location of users, and not by reference to value creating activity of the enterprise.

We note that a nexus rule based on market criteria such as customers or users is one of the elements in the Draft MLC definition of precluded taxes. We agree that such a criterion is an important element of the definition. Amount A itself, of course, includes both nexus and allocation rules based on market criteria. The essence of the Amount A compromise is that the new entitlement to tax Amount A requires the party to refrain from asserting other nexus claims beyond international norms, especially on a legislative basis intended to discriminate against digital service providers.

Gross-Basis Taxes on Digital Services

DEG members also have observed an increase in gross-basis taxes on income recognized by nonresidents with respect to the provision of digital services. The most obvious manifestation is the recent adoption of Article 12B of the UN Model Double Taxation Convention. Article 12B sanctions the imposition of withholding taxes on cross-border payments specifically for digital services. The legislative intent behind such taxes would be similar to those behind SEPs and DSTs, in that in all three cases the legislature intends to impose tax on nonresidents without a physical presence in the jurisdiction. Gross-based withholding taxes are inherently more distorting than other taxes simply because they impose tax on a gross basis and not net income. When combined with explicit discrimination based on business sector, these taxes are exceedingly destabilizing.

This case provides the best explanation of why the current definition of DSTs and relevant similar measures in the Draft MLC needs to be more flexible, to ensure that taxes such as withholding taxes imposed solely on payments for automated digital services are precluded under Pillar One. The draft definition apparently would not preclude these taxes, on the basis that the taxing state could assert that if a treaty applied to the transaction, the treaty PE rule would preclude the tax. The U.S. treaty network is less developed than that of many of its major trading partners, in particular with countries which are likely to consider an Article 12B type tax.[7] Article 12B withholding taxes should not avoid the obligation to be withdrawn simply because they take the form of a traditional withholding tax as opposed to a novel nexus standard.

[7] As explained by Carlos Protto, Argentina's Director of International Tax Relations, the intent of Article 12B is to address "the tax-treaty barrier that prevents source States from levying taxes on business profits in the absence of physical presence." Carlos Protto, *Redistributing Taxing Rights to the Global South Through the Digitalized Economy*, SouthViews (November 30, 2020), *available at* https://www.southcentre.int/wp-content/uploads/2020/11/SouthViews-Protto.pdf.

These Elements do not Merely Implement the BEPS Project Policies

Taxes exhibiting one or more of these four features cannot be fairly described as additional safeguards against BEPS, as described in the Action 1 Final Report. The BEPS Project focused on various aspects of the international tax system that affect the ultimate allocation of taxable profits, such as hybrid arrangements, transfer pricing rules, harmful tax practices, and the like. DSTs and similar measures do not address those BEPS issues. They endeavor to impose special and different taxes on nonresidents operating in the digital services sector.

Accordingly, DEG members were encouraged by IF members' agreement, reflected in the October 8, 2021 Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the **"October 2021 Statement"**), not to impose new unilateral measures, and to give the IF the breathing room to negotiate and refine Pillar One. Acknowledging that this standstill agreement will expire at the end of 2023, we strongly encourage Treasury to continue its negotiations to extend the standstill agreement.

If the Draft MLC enters into force, it can only be amended by a consensus of the Conference of the Parties. Thus, the DEG does not anticipate that the final MLC will be amended easily or frequently. Accordingly, it is critical that the definition of DSTs and relevant similar measures in the Draft MLC cover all of the forms of destabilizing taxes which have appeared since the Action 1 Final Report, as well as provide sufficient flexibility to respond to similar (but perhaps not identical) future measures.

Comments on Definition of DSTs and Relevant Similar Measures

Article 39 of the Draft MLC establishes a three-pronged, conjunctive definition of DSTs and relevant similar measures. We appreciate that a goal of the draft is to provide a definition which is relatively objective. We fear, however, that the draft definition will be too limiting. We provide our comments on each of the requirements below.

Article 39(2)(a) - Market-Based Criteria

We observe that the first requirement of the definition in Article 39(2)(a) was unchanged from the December 2022 consultation draft. This element, which focuses on whether the application of the tax, or the amount of tax imposed, is determined primarily by reference to the location of customers or users, or other similar market-based criteria, is a significant feature of destabilizing unilateral measures. As discussed above, the use of market-based criteria for purposes of determining nexus is a significant deviation from international norms of jurisdiction to tax. We therefore support the inclusion of this requirement and recommend that Article 39(2)(a) be retained in the definition of DSTs and relevant similar measures.

Article 39(2)(b) - De Jure or De Facto Discrimination

The second requirement of the definition of DSTs and relevant similar measures focuses on whether a measure is discriminatory with respect to nonresidents, either by express mandate

or in practical effect. We observe that the current draft includes some significant changes to this element of the definition. While the test for whether a measure is *de jure* discriminatory was unchanged, the portion of this requirement that assesses *de facto* discrimination itself now contains both two conjunctive tests and a carve-out based on the policy objectives of the tax.

Under the conjunctive *de facto* test, a measure must apply revenue thresholds, exemptions for domestic taxpayers, or other scope restrictions that both (1) cause the measure to apply in practice "exclusively or almost exclusively" to nonresidents or foreign-owned businesses, and (2) have the effect of "insulating" domestic businesses from the application of the tax. We observe that the second element of this dual conjunctive test appears to render the first element moot. A tested tax will not be a DST or relevant similar measure unless it meets both of these conjunctive criteria. If the legislation does not "insulate" all domestic taxpayers, then the tested tax cannot be a DST or relevant similar measure. The very strict standard of the "insulate" requirement seems to displace any role in the analysis for the "exclusively or almost exclusively" requirement.

The "almost exclusively" requirement suggests that a measure can be *de facto* discriminatory, even if it applies to some domestic taxpayers. As noted in the Explanatory Statement, a measure will be considered to apply "almost exclusively" to nonresident or foreign-owned businesses "if only a few percent of the taxpayers were both resident and domestic-owned."[8] However, if a measure has the "effect of insulating domestic businesses from the application of the tax" and thus satisfies the second conjunctive requirement of the *de facto* discrimination test, then the tax inherently does not apply to domestic owned businesses. The Explanatory Statement again appears to anticipate this outcome, stating that "a measure is regarded as insulating domestic businesses when it is designed in a way that *prevents* them from being covered."[9] We do not see how the terms "insulate" and "prevent" interact with the "almost exclusively" requirement to give both requirements of the *de facto* discrimination test independent significance.

Reading the two conjunctive requirements together therefore creates a test that an MLC Party could assert excuses any measure that applies to even one domestic business. The first element of the *de facto* discrimination test and the Explanatory Statement appear to acknowledge that a measure can be discriminatory even if it applies to some domestic businesses in practice. The second element of the test seems to undermine that understanding, as it seems to duplicate the "almost exclusively" requirement, but in a much stricter way. Given the conjunctive nature of this test, a measure that is not described by the "insulate" criterion cannot be a DST or relevant similar measure. That opens a window for future discriminatory measures to escape the MLC prohibition.

The DEG believes that the *de facto* discrimination test can be amended to restore a more effective standard by eliminating the second conjunctive requirement of the test in Article

[8] Explanatory Statement, paragraph 936.
[9] Explanatory Statement, paragraph 938 (emphasis added).

39(2)(b)(ii)(B). This element is largely duplicative of the first element in terms of intent, though it creates a higher standard that allows a tested tax to escape sanction even if it clearly applies almost exclusively to nonresidents. Thus, we believe a conjunctive *de facto* discrimination test is not necessary, and that discrimination is adequately addressed through the question of whether the measures applies in practice exclusively or almost exclusively to nonresidents or foreign-owned businesses.

The DEG also recommends that the standard for determining whether a measure applies "almost exclusively" to nonresidents should be revised to acknowledge the actual application of existing DSTs. As noted above, the Explanatory Statement provides that a measure will be considered to apply "almost exclusively" to nonresidents or foreign-owned businesses if only a "few percent" of the taxpayers were domestic businesses. This arithmetic approach which draws the line at a very low level runs the risk of excusing even existing DSTs. We understand that some domestic taxpayers exist even for some of the DSTs listed on Annex A. A jurisdiction with a DST might argue that this fact would excuse their tax under this test, as not imposed "exclusively" on nonresidents.

Even if some residents are subject to the tax, that does not remove the destabilizing and discriminatory nature of the tax when the legislative intent so clearly is to impose the tax principally on nonresident digital service suppliers. Governments intent on avoiding charges of prohibited discrimination under trade agreements also have considered where to set revenue or other thresholds. Those efforts in no way negate the observation that the principal legislative purpose of the DST is to tax nonresident digital service suppliers.

Causing the tax to be a precluded tax or not based on fine margins of "a few percent" of domestic taxpayers will create great uncertainty in the application of the rules. For example, under a mechanical rule the emergence of one or more local digital service providers could cause the tax to no longer be precluded on the basis that more than "a few percent" of the total taxpayers are now domestic businesses. The emergence of new local businesses, however, does not in any way detract from the point that the original purpose of the tax was to tax the profits of nonresident digital service providers. Similarly, if a local enterprise is acquired by a foreign group, that could reduce the number of locally owned businesses to fewer than "a few percent" so that an allowed tax suddenly is precluded due to the acquisition.

These examples demonstrate that a rule which incorporates the policy intent of the tax is a more principled, and perhaps even more stable, approach than one which bases the preclusion of the tax on business fortuities that could cause the number of domestic taxpayers to fluctuate above or below a line defined as "a few percent". Basing the definition on the number of local taxpayers also requires constant reporting by the taxing state of the number of total taxpayers and the number of local taxpayers, as well as an assessment by that taxing state of the ownership structure of local entities which are liable for the tax. A test based on the observed policy purpose of the tax will avoid that complex, intrusive and burdensome reporting requirement by the taxing state.

Even as a matter of arithmetic, the interpretation of "almost exclusively" should be modified to require a much greater incidence of domestic taxation before a tested tax could be excused. Because many unilateral measures are targeted at only a small number of businesses (e.g. the global major digital services providers), even a single domestic taxpayer could cause domestic taxpayers to comprise more than a "few percent" of all taxpayers.

If this sort of numerical comparison is retained, we recommend that the "almost exclusively" test instead look to the percentage of total tested tax revenue derived from domestic businesses. As the draft text is Article 39(2)(b)(ii)(A) is ambiguous as to how to apply the test of a tax "applying" in practice, either the MLC text or the Explanatory Statement should clearly state that relative tax collected is a basis to find *de facto* discrimination.

It may be difficult to set a single percentage of revenue that could be applied to all tested taxes across all jurisdictions. Accordingly, the better solution would be to add an element to this requirement that deems the *de facto* discrimination requirement to be met when the legislative intent is to impose the tax principally on nonresident digital service suppliers.

Addition of a Legislative Intent Factor

DEG members noted with interest the fact that the draft MLC has introduced an element of the definition which adopts exactly this suggestion, *i.e.* apply the legislative intent as a factor to determine whether the tested tax will be precluded. As drafted, however, this test is a one-way street, which could be used only to exclude taxes which may in fact be discriminatory. We suggest that, if the MLC retains this concept of applying a legislative intent factor, the text should be revised to cause a tested tax to be precluded when the legislative intent is to impose the tax primarily on nonresident digital service suppliers, even if the tax fails one or more of the several conjunctive requirements in Article 39(2)(b).

As drafted, the new flush language in revised Article 39(2)(b)(ii)(B) provides that the determination whether a measure has the effect of insulating domestic businesses:

> shall take into account all relevant facts and circumstances, including the policy objectives of the tax and the overall distribution of domestic and foreign businesses in that Party. The mere fact that there are few or no domestic enterprises in the relevant market is not dispositive.[10]

The reference to the policy objectives of the tax would appear to allow otherwise discriminatory measures to persist, as long as there is a non-tax policy basis for the measure. The Explanatory Statement supports this reading of the flush language, providing that:

> When the exclusive or almost exclusive application of a measure to domestic or foreign-owned businesses is the result of the pursuit of policy objectives that are not

[10] Article 39(2)(b)(ii)(B), flush language.

> related to the insulation of domestic businesses, and the legislative features are consistent with these objectives, the measure shall not be considered as ring-fenced.[11]

Retaining this standard seems to allow countries to impose discriminatory measures as long as they develop a plausible, non-tax policy reason for doing so. This would create a significant loophole in the *de facto* discrimination test that significantly undermines its effectiveness. The standard allows the purported non-tax policy rationale to override the discriminatory tax impact, without a weighing of the two.

The DEG believes that the flush language should either be modified, or it should be deleted.

The most appropriate modification, if this element is retained, would be to make the policy review consistent with the purpose of Amount A to preclude unilateral measures which intend to tax the profits of nonresident digital service providers. We therefore recommend that the flush language be revised to provide that if a measure satisfies the first and third requirements of the definition in Articles 39(2)(a) and 39(2)(c), and the tax was imposed for a significant purpose of taxing the profits of nonresident digital service providers, the measure will satisfy the discrimination requirement in Article 39(2)(b). This modification would better align the overall definition of a precluded tax with the broader intent of Amount A to preclude taxes which discriminate against digital service providers.

If this clarification is not made to Article 39(2)(b), the DEG strongly suggests that the flush language should be deleted in its entirety. As proposed, it is a one-way street that can only cause a tax to not be a precluded tax, even if it meets on its face all of the other criteria in Article 39. We see no utility in a one-way street rule that is not connected with the policy reasons behind the Amount A preclusion of DSTs and relevant similar measures.

Article 39(2)(c) - Evasion of Tax Treaties

The third requirement of the definition of DSTs and relevant similar measures assesses whether a measure is treated as outside the scope of any agreements in force between the party imposing the tax and one or more other jurisdictions for the avoidance of double taxation with respect to taxes on income. As discussed above, designing the measure to fall outside the scope of tax treaties is a significant destabilizing feature of many unilateral measures. This design feature erodes the certainty that bilateral tax agreements provide to taxpayers and undermines confidence in multinational agreements. It also deprives parties to existing treaties the ability to resolve issues relating to the application of those measures through the bilateral dispute resolution process established in the treaty.

We observe that Article 39(2)(c) effectively excludes many withholding taxes that target nonresident digital service providers from the definition of DSTs and relevant similar measures. While the DEG acknowledges the importance of the third element and supports in principle the inclusion of this test in the definition of DSTs and relevant similar measures, we again note that the conjunctive and mandatory nature of this particular element may

[11] Explanatory Statement, paragraph 940.

significantly decrease the effectiveness of the definition, especially with respect to the newest wave of unilateral measures.

We recommend that the third requirement should include an exception that provides that the third requirement will not apply as an element of the definition of a DST or relevant similar measure if the measure is intended to apply exclusively or principally to the business sector of digital service suppliers. The DEG believes that this exception would significantly improve the effectiveness of the definition of DSTs and relevant similar measures, as it allows the definition to cover taxes which are clearly incompatible with the overall compromise of the Amount A agreement, such as withholding taxes on payments for the provision of automated digital services.

Exemption for Rules that Address Artificial Structuring

We acknowledge that the exemption in Article 39(3)(a) is meant to leave room in the international tax framework for IF members to impose measures that address transactions considered abusive. We note with concern, however, that this concept is defined as measures which address "artificial structuring" to avoid traditional permanent establishment or nexus requirements as opposed to basing this exception on more common abuse of law concepts. Framing the exemption as applying to "artificial structuring" would appear to authorize countries to enact measures that unilaterally impose extraterritorial nexus rules in cases where taxpayers have taken business decisions on how to structure their operations that are far removed from cases of actual legal abuse.

In several recent cases, jurisdictions have enacted legislation intending to assert domestic tax jurisdiction over profits of nonresidents on the justification that the legislation constituted an anti-abuse rule. In fact, those statutes are more properly described simply as implementing a policy goal to impose tax on the profits of a nonresident in certain cases where those offshore profits would not be subject to tax in the market state under existing international tax norms and transfer pricing principles. The UK Diverted Profits Tax and the Australian Multinational Anti-avoidance Law are two examples of this sort of extraterritorial tax.

We recommend that the "artificial structuring" exception be placed on the much sounder basis of measures which are justified on the basis of common abuse of law principles. Otherwise, an exception that allows any extraterritorial imposition on the basis that the tax is labeled as responding to "artificial structuring" risks rendering Article 39 impotent.

We are not aware of any well-recognized public international law doctrine based on the concept of "artificial structuring." The MLC has the potential to reset international tax norms in various ways. The DEG does not believe it is prudent to enshrine in the MLC a concept of "artificial structuring" which has no public international law precedent.

We note that anti-abuse mechanisms are discussed extensively in the Commentary to the OECD Model Convention.[12] This Commentary can provide precedent for the appropriate

[12] *See* Commentary to Article 1 of the OECD Model Convention, paragraphs 54-80.

contours of a true anti-abuse measure for inclusion in a treaty. While the Commentary makes clear that countries should be able to protect against abuse of tax treaties or domestic law, it does not authorize broad measures that would render the country's commitments under the treaty hollow. We highlight, in particular, the sentiment expressed in paragraph 61 of the Article 1 Commentary: "it is important to note, however, that it should not be lightly assumed that a taxpayer is entering into the type of abusive transactions" that are often the subject of anti-abuse rules.

The DEG recommends that IF members negotiate in good faith to consider placing certain current " artificial structuring" measures on Annex A. The UK recently announced that it will withdraw its ORIP tax, which was another unilateral measure designed to tax the offshore profits of nonresidents. The tradeoff of the allocation of Amount A entitlement for unilateral measure withdrawal will only truly balance when IF members agree to withdraw measures structured in a manner that are duplicative to the new nexus standard established under Amount A.

If the "artificial structuring" exclusion remains in the MLC, we recommend that any measure that is proposed to be excepted on the grounds that it protects against "artificial structuring" undergo review by a panel process similar to the review processes established in Annex H. That review should weigh the precision of the definition of "artificial structuring" against the inevitable destabilizing effect of a nexus rue not based on common abuse of law concepts. The measure should be assessed for substantial compliance with the guardrails for abuse of law measures referenced above. For purposes of weighing the anti-abuse definition with a measure's destabilizing features, the panel should consider whether the measure would otherwise fall within the definition of DSTs and relevant similar measures, but for the exemption. Further, we recommend that the panel consider whether the measure requires an appropriate jurisdictional connection between the taxpayer and the taxing state. We note that, under some measures, the tax liability falls on a local affiliate, even if the tax is imposed on and is determined with respect to the income of a nonresident parent or group entity. This secondary liability imposition itself should be evidence of questionable jurisdiction, as the taxing state has essentially conceded that it does not have sufficient jurisdictional connection with the nonresident taxpayer to enforce the tax.

The IF should also ensure that any measures that are allowed to continue under the exemption in Article 39(3)(a) are accounted for in the Amount A calculation as a tax collected by the market state for purposes of the Marketing and Distribution Profits Safe Harbor (**"MDSH"**). Any tax levied under such measures represents the assertion of taxing jurisdiction over the residual profits of the taxpayer. Accordingly, measures falling within the exemption (either for "artificial structuring" or abuse of law), as well as any other measures with similar effect not withdrawn under Articles 38 and 39, should be treated as taxes on residual profits already imposed by the market state for MDSH purposes.

Comments on Article 40

As the DEG has previously commented, the third, conjunctive element of the definition of DSTs and relevant similar measures would effectively exclude SEP rules, which are typically covered by tax treaties. We were therefore encouraged by the inclusion of Article 40 to address SEP rules. Article 40 acts as an override to the third element of the definition in Article 39(2)(c), providing that if (1) a measure falls outside the scope of the definition because it does not meet the condition described in Article 39(2)(c), and (2) the measure is based on criteria including local sales, number of users, or targeting of a domestic audience (which do not require physical presence in the jurisdiction), the measure will not be imposed on a Group Entity (*i.e.* Amount A taxpayers). This rule, in effect, requires Parties to the Draft MLC to not impose their SEP rules on Amount A taxpayers.

While we applaud the IF for this significant expansion of the definition to include SEP rules, we note that this relief applies only to Amount A taxpayers. We assume that the justification for the proposed limited applicability of this override only to Amount A taxpayers is that SEP rules create nexus bases on sales that is similar to the nexus standard that is now the basis of Amount A.

While we agree that the SEP nexus concept duplicates the new nexus entitlements of Amount A, it is also true that the SEP rules are a destabilizing element generally. SEP rules have the same general purpose as DSTs, namely to impose tax on nonresident suppliers based on market factors where the supplier interacts with the market through digital means. There is no reason to distinguish SEP nexus rules from DSTs from the perspective of removing measures which destabilize the international tax framework. Thus, we strongly recommend that the carve-out in Article 40 be expanded to all taxpayers, not just Amount A taxpayers.

We understand that the IF may have intended Article 40 to result in the complete preclusion of SEP nexus rules. If so, the Draft MLC text does not make that intention clear. We therefore recommend that the text of Article 40 be clarified to ensure that intended result.

The DEG also recommends that the measures that would be described in Article 40 be added to Annex A. It is just as important to provide certainty with respect to these provisions as it is with respect to current measures that fall within the scope of the definition in Article 39(2). We observe that paragraph 961 of the Explanatory Statement provides that the review process in Annex H does not apply for purposes of determining whether a measure meets the conditions of Article 40, and instead leaves this question to administrative and judicial procedures similar to those available under a tax treaty. This creates an illogical distinction in the review process scope. We therefore recommend that Article 40 measures should be reviewable under the process detailed in Annex H. Further, imposition of a measure described in Article 40 should carry the same consequences as the imposition of a measure that falls within the definition in Article 39(2), particularly with respect to the imposing jurisdiction's Amount A allocation.

Comments on Article 38

We observe that Article 38(1) provides that a Party shall not apply any measure listed in Annex A to any person as from the date specified in Article 49(4). Article 49(4) provides that:

> Article 38(1) shall have effect in a Party as from the first day of the next calendar year that begins on or after the expiration of a period of six months from the date on which this Convention enters into force for that Party.

This provision aligns the removal of measures listed on Annex A with the date on which the Convention enters into effect for a particular party. At least for parties that join the MLC within a few years of when the MLC is open for signature, the DEG recommends that the removal of measures listed on Annex A instead align with the entry into force of the Convention generally once the critical mass has been achieved.

Moreover, we strongly recommend that all IF members extend the standstill and rollback agreement to allow for the signature and ratification process to proceed under more stable circumstances. Many jurisdictions have already paused or suspended their unilateral measures during the negotiation process, contingent upon the success of Pillar One. In our view, countries which rush to impose a unilateral measure soon after 2023 would not exhibit a good faith commitment to multilateral cooperation and the OECD/IF project in general. Rather, such actions are likely to set back the progress that the IF has made to date.

Comments on Annex A

We agree that all of the measures listed on Annex A should be withdrawn. We also suggest that Annex A contain certain additional measures, such as subnational DSTs or similar taxes, various European digital content taxes that are intended to discriminate against nonresident digital service providers, and existing SEP nexus rules that are described in Article 40. In addition, withholding taxes on income derived from the provision of digital services should also be included on Annex A, in line with our recommended expansion of the definition above.

Specifically with respect to digital content taxes, we believe there are currently several measures in effect or being considered which have discriminatory and destabilizing features. Further, many of these measures were enacted with the specific intent to target nonresident digital services suppliers. For example, the French tax on video content was intended to reach nonresident providers of video content. This measure applies based on the provision of such content to the French public, thus satisfying the first element of the definition of DSTs and relevant similar measures. Further, France does not treat this measure as a covered tax under its tax treaties, satisfying the third element of the definition. Finally, though the measure can apply to both residents and nonresidents by its terms, the definition of in-scope activities makes it likely that the measure applies almost exclusively to nonresidents. Further,

the tax paid under this measure is deductible against French corporate income tax. Thus, any resident taxpayer is less likely to owe additional tax in the aggregate, as compared to nonresidents.

We would be happy to provide further information on other taxes that have been enacted with the legislative intent to impose tax on nonresident digital services providers for inclusion on Annex A.

Comments on Annex H

Annex H to the Draft MLC provides details regarding the review process and early clarification with respect to DSTs and relevant similar measures. We appreciate the detail provided in Annex H, and in particular the attentiveness to time limits on the stages of review.

However, the DEG is concerned that a process that requires review by and consensus of the entire Conference of the Parties will not be able to effectively sanction measures that are principally intended to tax the profits of nonresident digital service providers. The IF should instead adopt for this purpose a Panel Review Process similar to those proposed in the Amount A Tax Certainty rules. Alternatively, the *ad hoc* process described in paragraphs 7 and 8 of Annex H could be established as the principal forum in which to address these issues, as opposed to being a process which is empowered only after a year of deliberation by the Conference of the Parties. A process which moves in the first instance to the *ad hoc* panel process will produce a more streamlined and efficient determination process.

With respect to the *ad hoc* panel process, we recommend that the panel be composed in a manner that ensures the measure is reviewed by parties selected to ensure an informed review of the contested measure. We recommend that the panel be composed of seven members, one of which is the requesting Party. At least three of the remaining panel members should be drawn from those states which would be expected to be the top five states affected by the contested tax, excluding the initiating state. The amount of tax expected to be borne by a state should be based on the aggregate of the contested tax projected to be paid by all members of groups with a common parent entity resident in that state. If three such states do not choose to participate, then states of residence of any taxpayer which is expected to be subject to the contested tax should be eligible to participate as one of the three members from tax paying states, with priority being given in order to those states whose resident entities are expected to bear the highest amount of the contested tax. The remaining three members should be selected by the same processes used to select the Determination Panels.

We also were encouraged that the review process will consider subnational DSTs and relevant similar measures. We appreciate that, as stated in the Explanatory Statement, the efforts expected of a Party to encourage a subnational jurisdiction to remove its subnational DST or relevant similar measure is subject to the norms of its constitutional order. However, we recommend that the IF provide more guidance as to what is expected of the Party, and

establish relief measures for taxpayers subject to such taxes in cases of prolonged noncompliance by the subnational jurisdiction. Absence of a system of financial consequences for the national state would create inappropriate incentives for national jurisdictions to encourage or at least tolerate the imposition of DSTs and relevant similar measures at the subnational level.

Comments on Amount B

Though not covered by the Draft MLC, we would like to take this opportunity to provide comments regarding Amount B of Pillar One, which aims to facilitate compliance and reduce disputes relating to the remuneration of related party distributors that perform baseline marketing and distribution activities in a manner that is aligned with the arm's length principle. The DEG sees Amount B as a critical part of the overall goal of Pillar One to stabilize the international tax system. We were therefore encouraged by recent comments from Treasury officials that emphasized the need for a robust Amount B in order to reach agreement with respect to Amount A.

DEG members fully endorse the stated goals of Amount B, as highlighted in the Report on the Pillar One Blueprint:

> First, Amount B is intended to simplify the administration of transfer pricing rules for tax administrations and reduce compliance costs for taxpayers. Second, Amount B is intended to enhance tax certainty and reduce controversy between tax administrations and taxpayers. In these ways, Amount B has the potential to address certain challenges that tax administrations face in evaluating the arm's length nature of the pricing of distribution arrangements adopted by MNE groups. Distribution arrangements constitute an area of concern for tax administrations and taxpayers alike and are a frequent focus of domestic transfer pricing controversy. They are often the subject of dispute between tax authorities, and require settlement under the MAP provided for in bilateral tax treaties. For these reasons, many governments and businesses view improvements in this area as a key deliverable of Pillar One, on the presumption that the design features of Amount B are such that these key benefits may be realised in practice. [13]

The consultation document on Amount B issued on July 17, 2023 provided that Amount B would only apply to transactions involving the wholesale distribution of tangible goods. Though the consultation document indicates that the IF is still considering the inclusion of distributors of digital goods, even that potential expansion would exclude distributors of services. We believe that the exclusion of either (and especially both) digital goods or services misses an important opportunity for the IF to achieve the goals of Amount B for this

[13] OECD (2020), *Tax Challenges Arising from Digitalisation – Report on the Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/beba0634-en, para 655.

important sector of the global economy, and we urge that they be included in the final scoping criteria.

The digital goods and services sector is a major part of the global economy, and will grow in significance in the future. We question why as a policy matter an important and growing sector in the global economy would be excluded from Amount B. We believe that including digital goods and services will materially advance the goals of Amount B to significantly reduce transfer pricing controversies over what should be noncontroversial matters and contribute to the stabilization of the international tax framework.

We consider it particularly curious that digital goods and services would be excluded from Amount B, since much of the impetus behind the entire Pillar One project in the first place was to address cross border transactions in digital goods and services. Amounts A and B were created as complementary mechanisms to stabilize the international tax framework. Regardless of the ultimate fate of Amount A, Amount B will continue to play that role in the context of cross-border baseline distribution activity. With the rise of the digital sector being a principal reason for the Pillar One project, we suggest that the IF should strenuously endeavor to bring the digital sector within the scope of the Amount B solution, not to exclude it.

DEG members report that they have been able to test the results of baseline distribution for digital goods and services under the same methodology that will be followed for Amount B, with no conceptually different issues than for baseline distribution in other sectors. DEG members report that they have been able to identify appropriate comparables, make appropriate adjustments, and choose an appropriate TNMM-based profit level indicator for these transactions in the same way as is apparently being done in the Amount B project.

We speculate that the hesitation to include services within the scope of Amount B is based on an assumption that businesses adopt a wide variety of forms of service delivery, including where the selling entity itself performs the value added activity of performing the service. That latter description typically will not exist in the distribution structures used by DEG members, or by similarly situated groups. The production and delivery of digital services, namely the development, enhancement, and delivery of the service, and the investment in IT infrastructure required to deliver the service, typically is not undertaken by a distributor established in a market state. The entity involved in distributing the digital service engages only in distribution of access rights to customers, not in the value added activity of development and actual delivery of the service.

At minimum, the IF should make Amount B available to all Amount A taxpayers, regardless of industry sector. The currently proposed scope would deprive many of the biggest Amount A taxpayers of the dispute minimization and transfer pricing stabilization benefits of Amount B. Taxpayers providing digital goods and services are likely to bear a significant proportion of the additional tax owed under Amount A. Amounts A and B were conceived of as parallel and complementary mechanisms to restabilize the international tax framework. By limiting Amount B as proposed in the July 17, 2023 consultation document, the IF will create

drastically different outcomes under Pillar One depending on the industry of the taxpayer. We strongly recommend that Amount B be expanded to provide more uniform outcomes under Pillar One, and specifically ensure that all Amount A taxpayers have access to the dispute minimization and transfer pricing stabilization benefits of Amount B.

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We appreciate your consideration of the comments in this letter, and we would be pleased to provide further comments or elaboration of these points at your convenience.

Sincerely,

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