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by e-mail: OTP_Pillar1MLC@treasury.gov

Michael Plowgian
Deputy Assistant Secretary (International Tax Affairs)
U.S. Department of Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Re: Comments Regarding Draft MLC for Pillar One Amount A

Dear Mr. Plowgian:

The Silicon Valley Tax Directors Group (**"SVTDG"**)[1] appreciates the opportunity to provide input on the draft OECD/G20 Inclusive Framework Multilateral Convention to Implement Amount A of Pillar One ("draft MLC") and accompanying documents. We applaud the decision of U.S. Treasury to request public input on the draft MLC. This is the first opportunity for stakeholders to see the draft MLC in its entirety. We appreciate the Treasury's request that stakeholders consider in particular how the different parts of the MLC fit together.

We note that the draft MLC text presents some significant improvements over the previously-released OECD consultation documents. Nevertheless, we see room for further important improvements to some aspects of the draft MLC, in particular in the areas of defining digital service taxes or other relevant similar measures, as well as other related design features, which we will describe in this letter. We strongly encourage the Treasury to advocate for these important refinements. We also suggest that the Treasury and Congress will need additional time to assess whether the final MLC and related features, as a whole and taking into account further refinements, will achieve the goal of stabilizing the international tax framework.

Improvements Over Prior Consultation Documents

We appreciate the significant improvements included in the draft MLC compared to the text released in the prior consultation documents. Those include:

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[1] The SVTDG represents U.S. high technology companies with a significant presence in Silicon Valley that are dependent on R&D and worldwide sales to remain competitive. The SVTDG promotes sound, long-term tax policies that allow the U.S. high tech technology industry to continue to be innovative and successful in the global marketplace.

- a mandatory binding certainty process for issues related to Amount A (subject to the election under Article 36 granted to many developing countries to be exempt from the mandatory binding process);
- the partial inclusion of source state withholding taxes in the calculation of the Marketing and Distribution Profits Safe Harbor ("MDSH");
- the addition of an autonomous domestic business exception;
- the recognition that significant economic presence permanent establishment nexus rules duplicate the purpose and effect of Amount A and thus should not be applied with respect to Amount A taxpayers; and
- the inclusion of subnational taxes as possible digital service taxes ("DST") or other relevant similar measures ("RSM").

That said, we believe that further significant improvements can be made in many of these and other areas, even as we recognize that these have already been heavily negotiated to address the interests of participating countries. We encourage U.S. Treasury to continue to engage with Inclusive Framework members on the remaining open points. We provide our further comments below.

Focus on the Ultimate Goal - Stabilization of the International Tax Framework

Before addressing specific issues regarding the draft MLC text, we would like to observe that further work on this project should proceed in clear recognition of the goal of this project. The clearly stated purpose of Pillar One is to stabilize the international tax framework. The agreement to allocate taxing rights over Amount A to market states constitutes an unprecedented and dramatic shift in the allocation of taxing rights globally. It bears added emphasis that the formulary design approach will inevitably lead to unexpected outcomes when applied to the particular facts and circumstances of companies, which needs to be recognized by all countries participating in this process. The proposed regime is expected to reallocate very substantial amounts of taxable income; the most recent OECD impact assessment estimates that $204.6 billion would have been allocated in 2021.[2] A large part of those profits will be earned by U.S. multinationals, although the impact of that to the United State fisc is less clear, in light of individual company circumstances when subjected to the design features of Amount A and the extent to which the taxes will be creditable.

This reallocation is predicated on a mutual agreement among the parties to the MLC, namely that steps will be taken to stabilize the international tax framework. The imposition of DSTs has been the most high profile of the various destabilizing actions, and the MLC properly requires withdrawal of all DSTs that fall within the definition of DSTs / RSMs in the MLC. Other unilateral measures, however, have similarly contributed to destabilization, including measures seeking to reach the profits of nonresidents through approaches expressed as anti-abuse measures, new significant economic presence nexus rules, special taxes imposed on streamed content delivered by nonresidents, new or expanded withholding taxes contrary to established international norms and treaties, aggressive transfer pricing and taxable nexus assertions, and the like.[3]

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[2] Update to the economic impact assessment of pillar one: OECD/G20 Base Erosion and Profit Shifting Project, OECD Taxation Working Papers No. 66 (2023).

[3] We also note that the draft MLC text as proposed may not eliminate all DSTs, in that governments may find ways to introduce taxes on digital services which do not fall within the narrow definition of DSTs / RSMs in the draft MLC.

All of these measures have been motivated, at least in part, by the desire of legislatures or tax administrations to develop measures to tax profits which have been earned by nonresidents from sales made into those market states which are not taxable by the market state under existing rules. Amount A precisely addresses that market state desire. The withdrawal of DSTs as defined is an essential, but not complete, element of the restabilization. Accordingly, we suggest that the MLC process should include some expression of intent by the parties, even if not incorporated in terms of the MLC, that the grant of Amount A allocations is the agreed contribution by residence states to achieve the quid pro quo of a stabilized international tax framework, so that the parties expect that national measures will operate within the newly agreed division of source and residence taxation set by the existing underlying framework as supplemented by Amount A. In the event that the parties do not agree to such a statement of intent, we encourage the U.S. Treasury to maintain this position in future international tax discussions.

We also note that access to a robust and broad Amount B (that covers services) is another key factor to achieve a more stable international tax framework. We urge the Inclusive Framework to prioritize that work as a necessary element of the overall Pillar One project.

DST / RSM Definition Should Be Broader and More Flexible

The DST / RSM definition needs to provide the U.S. Treasury with treaty text which is fit for purpose to respond to future creative unilateral measures intended to impose tax on the profits of nonresident suppliers of goods and services in the digitalized economy. We are concerned that the current text has been drafted too narrowly in an apparent effort to describe only existing DSTs. We suggest that the definition should include other elements which allow the Treasury to oppose other unilateral measures that have the same purpose as DSTs. In particular, the definition should include taxes which may not meet the very narrow draft MLC criteria but are expressly focused on taxing nonresident digital service providers, such as the withholding taxes on payments for automated digital services anticipated in Article 12B of the UN Model Convention.

We believe that the multi-factor conjunctive test in the draft MLC is too narrow to achieve the Pillar One stabilization goal. We refer to our January 20, 2023 submission for the Consultation on "Amount A: Draft Multilateral Convention Provisions on Digital Services Taxes and Other Relevant Similar Measures". We identified in that submission the need to develop a definition that is flexible enough to describe not only DSTs / RSMs now in effect, but to anticipate possible additional measures that might be developed in the future designed to tax the profits of remote digital services providers. In that submission, among other proposals, we suggested developing a list of potential destabilizing features. Our proposal was similar in design and effect to the "hallmarks" proposals from other commenters. A tax which includes any of those potential destabilizing features would be subject to closer review. The final determination would be based on whether the tax, in light of all the factors, is designed to achieve the same goal as the existing DSTs, namely taxing nonresident digital service providers.

For the foreseeable future, there is little doubt that any new unilateral measures that are designed to tax the profits of nonresident digital services suppliers will disproportionately impact U.S. companies. A narrow, mechanical definition in the MLC implicitly authorizes any unilateral measure which falls outside its mechanical boundaries. We believe that U.S. Treasury needs the appropriate tools to respond to creative future unilateral measures.

Accordingly, for the reasons described in this section, we recommend that the tests in Articles 39(2)(b) and 39(2)(c) be amended to include consideration of whether a principal legislative purpose for the tax is to tax the profits of nonresident digital service providers. The Amount A project is a response to

unilateral efforts to tax the offshore profits of digital service suppliers. It is appropriate that the guardrails against similar future unilateral measures retain as a criterion whether a legislature intends to tax remote suppliers of digital services.

Article 39(2)(b)(i)

We agree that the element stated in Article 39(2)(b)(i) that the tax is applicable by its terms only to nonresidents or foreign-owned businesses is an important criterion in assessing whether a tax should be regarded as a DST / RSM. Most DSTs (including most of those listed on Annex A), however, do not by their terms apply solely to businesses carried out by nonresidents or foreign-owned businesses. Accordingly, a DST / RSM will only fall in scope of those measures to be withdrawn if the measure applies scope restrictions that are defined within Article 39(2)(b)(ii).

Article 39(2)(b)(ii)

We have significant concerns that the conjunctive elements in Article 39(2)(b)(ii), especially after the revisions added to the draft MLC after the Consultation draft, are too narrow and inflexible. The modification elaborates the prior text to make explicit a second conjunctive element to the definition. We believe that the second conjunctive element does not provide greater clarity to the rule. Rather, the effect seems to be to narrow the definition further.

The two definitional limitations in draft Article 39(2)(b)(ii) are themselves conjunctive, so a measure will escape classification as a DST / RSM unless it includes scope restrictions that both (i) "cause the measure to apply in practice exclusively or almost exclusively to non-resident or foreign-owned businesses", and (ii) "have the effect of insulating domestic businesses from the tax."

"Exclusively" and "insulate" are very restrictive terms.

Accordingly, as discussed further below, we suggest that the Article 39(2)(b)(ii) component of the definition be revised to include in the scope of the DST / RSM definition those taxes which are designed with a principal purpose to apply to nonresident suppliers of digital services. If this proposal is not adopted, the "exclusively" and "insulate" standards should be relaxed.

Article 39(2)(b)(ii)(A) - applies "exclusively or almost exclusively"

The Explanatory Statement provides at paragraph 936 with respect to the first element of "exclusive" or "almost exclusive" application:

> If all the in-scope companies are non-residents or foreign-owned businesses, then clause (A) is met. If there are some resident and domestic-owned businesses, it must be determined if their proportion is small enough for the measure to be considered as applying “almost exclusively” to non-resident or foreign-owned businesses. For example, it would be the case if only a few percent of the taxpayers were both resident and domestic-owned.

This test would seem to produce an absolute bar to a measure qualifying as a DST / RSM if even one domestic taxpayer is subject to the tax, unless the single domestic taxpayer is outweighed by a vastly larger number of nonresident taxpayers. This very narrow definition might encourage arguments that even some of those DSTs listed on Annex A are not covered by this definition. As noted, most of the DSTs listed on Annex A are not limited to nonresidents by statute. Further, we understand that in most of the countries listed on Annex A, one or more DST taxpayers are resident entities. Those entities necessarily are substantial enterprises, as they also exceed the revenue thresholds to become DST

taxpayers. Since the DST in most countries is focused as a policy matter on a few global digital services groups, as reflected in the threshold global revenue condition, the number of total taxpayers is relatively limited. Accordingly, even one domestic DST taxpayer could account for more than "a few percent" of total DST taxpayers.

The fact that there may be one or more domestic taxpayers does not affect the destabilizing nature of the DST / RSM. Even if some local taxpayers are affected, the fact that such measures are intended principally to apply to nonresidents, along with the other exacerbating element of being designed to fall outside the scope of existing tax and trade agreements, makes them inherently destabilizing.

If this type of comparison remains in the definition, a more appropriate frame of reference would be the relative DST payable by resident versus nonresident taxpayers instead of the number of taxpayers. One of the destabilizing elements of the current DSTs is that they are focused on taxing large nonresident groups. Even if several domestic taxpayers are within scope of a DST, the large majority of the liability will be borne by nonresidents. Accordingly, measuring disproportionate tax collected from nonresidents is a more appropriate indicator of a tax that is designed to tax nonresidents.

This could be established through an example in the Explanatory Statement. The Explanatory Statement could provide, for example, that if the tax collected from nonresidents totalled 70% of the whole across a stated measuring period, the tax would clearly meet the requirement of Article 39(2)(b)(iii)(A).

Article 39(2)(b)(ii)(B) - insulates domestic businesses

The second conjunctive requirement of Article 39(2)(b)(ii)(B) is that the effect of the tax is to "insulate" domestic businesses. This requirement appears even more restrictive than the "almost exclusively" test. The prior language from the Consultation draft referred to scope restrictions "that ensure that substantially all residents … are exempt from its application." "Insulate" is defined to mean "to set apart; to detach from the rest; isolate."[4] This definition would seem to create an even stronger bar to a unilateral measure being defined as a DST / RSM than the prior "substantially all" term if there is any domestic taxpayer. The Explanatory Statement at paragraph 938 provides as follows:

> Clause (B) provides that the concerned measure needs to have the effect of insulating domestic businesses from the application of the tax. In the context of the MLC, a measure is regarded as insulating domestic businesses when it is designed in a way that prevents them from being covered.

This explanation is equally rigid; the concerned measure satisfies this element only if it is designed to "prevent" domestic businesses from being covered. Even one domestic taxpayer would seem to take the measure out of the scope of this definition.

We appreciate that the genesis of this language may have been discussions over how to define a prohibited DST / RSM when, in fact, there are no domestic taxpayers supplying the relevant goods or services, and there are few prospects of domestic taxpayers emerging in the near future. We understand that the concern in that case is that the statute could be completely neutral on its face as to defining the relevant taxpayers, and use as its scope definition merely a description of the services being taxed. This is an important concern, since as other countries consider implementing DSTs, we expect that many will be enacted by countries which in fact have no domestic digital service supplier taxpayers due to the different stage in the development of their digital services sector.

We believe, however, that the new Article 39(2)(b)(ii)(B) is duplicative to Article 39(2)(b)(ii)(A) and should be removed. If that suggestion is not adopted, we strongly recommend the proposal discussed

[4] Webster's New Universal Unabridged Dictionary, Second Edition.

further below to introduce a further disjunctive element testing whether the tax was enacted with a principal purpose to tax nonresident digital service suppliers.

Article 39(2)(b)(ii)(B) (flush language) - taking into account policy reasons for the tax

We note that the additional text in Article 39(2)(b)(ii)(B) (flush language) introduces a new element which in practice, appears to allow an additional limiting condition. The new text provides that in determining whether the scope restrictions in the statute have the effect of insulating domestic businesses from the tax, the parties "shall take into account all relevant facts and circumstances, including the policy objectives of the tax and the overall distribution of domestic and foreign business" in the state.

The only apparent possible consequence of applying this text would be to allow a tax to escape sanction even if the scope limitations in fact insulated domestic businesses from the tax. The Explanatory Statement at paragraph 940 illustrates this effect, as follows:

> For the purpose of assessing a measure against clause (B), both the policy objectives of the concerned measure and the overall distribution of domestic and foreign businesses should be taken into account. Concerning the former, 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 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. The policy objectives of a measure would be reasonably concluded based on an examination of all facts and circumstances surrounding the introduction of the measure. For example, in a situation where all non-renewable energy providers are foreign-owned while domestic renewable energy providers exist, an environmental tax applying only to non-renewable energy providers should not be seen as meeting clause (B) due to the presence of an obvious policy objective unrelated to insulating domestic businesses – environmental policy.

As drafted and placed in the overall structure of Article 39, we are concerned that this introduction of a policy review which can have the effect only of excluding a tax from DST / RSM status provides too great leeway for states to propose facially plausible policy reasons to justify a tax on nonresidents under scope restrictions that insulate domestic taxpayers. This policy review, in context, is a one-way authorization.

Instead, we suggest that Article 39(2)(b)(ii) be modified to cause a unilateral measure to be classified as a DST / RSM if, in addition to satisfying the other criteria in Article 39(2)(a) and (c), the tax was imposed for a principal purpose of taxing the profits of nonresident digital service providers. The new flush language demonstrates that the delegates are not adverse to a test which requires examining the policy foundation for the tax to determine whether a new unilateral measure is a DST / RSM. This policy review would be even handed, to either support or oppose a determination that the unilateral measure is a DST / RSM.

The purpose of our prior proposal to identify certain destabilizing features was intended to identify those taxes which are designed with the policy goal of taxing nonresident digital service providers. If policy purposes are to be considered, then they should be considered in all cases. Accordingly, even if scope restrictions exist which do not "insulate" all domestic businesses, the tax should be regarded as a DST / RSM if a principal policy purpose of the tax is to impose tax on nonresident digital service providers. The first and third conjunctive requirements of Article 39(2)(a) and 39(2)(c) would remain as elements to define a DST / RSM, so that not all taxes imposed principally on nonresidents would fall under this definition.

If the draft flush language remains in the final MLC, in order to not give a legislature the opportunity to protect a tax based on a minor purpose, that other policy purpose should be the clearly predominant purpose, and be unrelated to any goal of imposing tax on the profits of nonresidents.

<u>Article 39(2)(c) - taxes outside of tax treaties</u>

SVTDG members certainly agree that a legislature's decision to impose a tax that is outside the scope of tax treaties is an important hallmark of a destabilizing tax. Some taxes which the jurisdiction acknowledge are within the scope of treaties also are destabilizing, however, so the DST / RSM definition should have the flexibility to address those. Principal among these taxes are withholding taxes on payments for automated digital services as contemplated by Article 12B of the UN Model Convention.

Article 12B taxes are clearly designed to allow states to tax the profits of nonresident digital service providers. As such, they duplicate the purpose of Amount A. By expressly applying only to the digital services sector, they are the archetype of a destabilizing tax. We expect that a jurisdiction which enacts such a tax would agree that the tax would be a covered tax under its tax treaties. Accordingly, an Article 12B tax would fail the criterion in Article 39(2)(c) and not be regarded as a prohibited DST / RSM.

Accordingly, we suggest that an exception be added to Article 39(2)(c) which provides that Article 39(2)(c) will not apply as an element of the definition of a DST / RSM if the tax is intended to apply exclusively or principally to the business sector of digital services suppliers. This exception also should apply to subnational taxes.

Alternatively, this exception to Article 39(2)(c) could be added to Article 40, which now includes the exception to Article 39(2)(c) for significant economic presence nexus rules. For taxes other than SEP nexus rules, however, the prohibition should apply to all nonresident taxpayers, not just Group Entities of Covered Groups.

<u>Article 39(3) - taxes excluded</u>

SVTDG members observe that certain European countries now have in place or are considering taxes imposed on the delivery of digital content by nonresidents. The purpose of these taxes is to impose taxes on the supply of digital content into the market by nonresident suppliers. Accordingly, these taxes should be removed under the MLC. We recommend that these taxes be added to Annex A and that the Explanatory Statement confirm that the exclusion for “similar taxes based on consumption” does not apply to these taxes imposed on payments for digital content.

<u>Summary of Recommendations</u>

In light of the discussion above, SVTDG members recommend the following revisions:

- Article 39(2)(b)(ii)(B) should be deleted as duplicative of Article 39(2)(b)(ii)(A).
- The measure of "almost exclusively" in Article 39(2)(b)(ii)(A) should be amended to reflect the fact that in many cases, states imposing DSTs may have one or more significant domestic DST taxpayers.
- This last point could be implemented with an overriding element that causes a tax that meets the other criteria in Article 39 to satisfy Article 39(2)(b)(ii) if a significant purpose of the legislation was to tax nonresident digital service providers. This should replace the draft flush language of Article 39(2)(b)(ii)(B).
- If the draft flush language is not amended as suggested above, it should be deleted.

- Article 39(2)(c) should have as an exception taxes whose principal purpose is to tax the profits of nonresident digital service providers. Alternatively this could be included in Article 40, but the requirement to not apply the tax would pertain to all nonresidents, not just to Group Entities of a Covered Group.
- Taxes imposed on the delivery of digital content by nonresidents, such as those now prevailing in certain European countries, should be added to Annex A as existing measures subject to removal.

Annex A Taxes

Those unilateral measures now listed on Annex A must be presumptively covered as a DST / RSM, even if significant domestic DST taxpayers now exist. The adoption of substantially similar taxes by those countries should be precluded, even if their digital service sector develops so that domestic taxpayers become a larger percentage of all taxpayers.

Determination Procedures

Finally, we note that under the MLC procedures, the determination whether a new unilateral measure is to be withdrawn ultimately may be made by majority vote of the Conference of the Parties. The United States apparently will have one vote out of the entire Conference, in contrast to the points system used for the introduction into force and the termination of the MLC. This enormously diluted voting power means that it is essential that the definition of a DST / RSM include taxes which have as one of their principal purposes the goal to tax nonresident digital service providers. The United States needs that tool in the text of the MLC in order to effectively oppose future creative unilateral measures which might target U.S. groups.

We endorse the proposal in Annex H paragraph 3 for the Depository to publish the decision of the Conference of the Parties whether a measure is a DST / RSM, in order to bring transparency to that process.

Standstill Agreements

We are encouraged by recent comments from Treasury officials that Treasury continues to work with all Inclusive Framework members to extend the standstill agreement on DST / RSM introductions beyond 2023, even if the MLC has not been signed by a critical mass of countries by the end of 2023. We also welcome the statements that Treasury and other departments and agencies of the U.S. government continue to press Canada to not proceed with their proposed DST. We are very concerned that other countries may follow suit if Canada successfully ignores the broader standstill agreement and move forward with a DST while productive discussions over the MLC are still ongoing. Finally, we encourage Treasury to engage with those countries with which the United States has bilateral arrangements regarding their existing DSTs to extend the agreement by those states to allow a credit of "excess" DST over a notional Amount A liability for earlier years until such time an MLC is in force. In the ongoing negotiations on the Canadian DST, we urge the administration to consider the broadened definition of a DST described herein rather than the narrow definition that exists within the MLC.

Sanction for Imposing or Not Withdrawing a DST / RSM

The failure by a party to the MLC to withdraw a DST / RSM or the decision to enact a new one should be regarded as a material breach of the MLC. Article 39(1) provides that a party which has imposed or not withdrawn a DST / RSM will not be allocated any Amount A for any period after the Conference of the Parties makes its determination. The Explanatory Statement at paragraph 922 also states that there is no obligation for a party to refund amounts collected under a DST / RSM that is found to be in violation

of the MLC.

We suggest that the consequences of this material breach should be modified in two ways. First, the breaching party apparently will continue to be treated as a party to the MLC. If so, that breaching party will continue to enjoy other benefits of the MLC, such as the right to serve on determination panels, participate in decisions rendered by the Conference of the Parties, and the like. We suggest that the consequences of a refusal to withdraw a DST / RSM should be the suspension of all rights under the MLC, not just the right to receive an Amount A allocation, until the DST / RSM is withdrawn. We suggest that it be clarified that the breaching party will not be entitled to obtain the Amount A tax return until the measure is repealed. The Explanatory Statement at paragraph 919 notes that such a party would not be relieved of the obligation to relieve double taxation under the MLC. We agree that the party could remain a party to the MLC for the purpose of fulfilling this or other obligations.

Second, we suggest various refinements to the procedures set forth in Annex H in the event that a concerned measure is determined to be a DST / RSM. A state which enacts a concerned measure shortly before the MLC is opened for signature should not be able to benefit from the lag of at least a year which results under the process described in Annex H paragraph 10(a)(i). Instead, a state which enacts a concerned measure which is determined to be a DST / RSM within the two-year period before the MLC is opened for signature should be subject to the more appropriate sanction of paragraph 10(b).

We endorse the three year retrospective withdrawal of Amount A provided in Annex H paragraph 10(b) for concerned measures enacted after the MLC has been opened for signature. We observe, however, that if the Conference of the Parties waives the requirement to forego Amount A taxation retroactively, double taxation will result for the period that both the DST / RSM and the Amount A entitlements are in place. Paragraph 2771 of the Explanatory Statement provides that this relief would be granted when "the retroactive denial of Amount A would have disproportionate consequences compared to the impact of the measure, taking also into account the extent to which Group Entities of Covered Groups are affected by it." While the Explanatory Statement provides that this facts and circumstances test is "objective", there is no suggestion as to what elements of the potential retroactive refund of Amount A would be considered "disproportionate". Given that Amount A reporting will be controlled centrally by the Covered Group, we suggest that the Covered Group in most cases easily will be able to determine the effects of the withdrawal of Amount A. Accordingly, we suggest that the retrospective withdrawal of Amount A should be presumptively the correct consequence, and that the Covered Group or the enacting Party should show compelling circumstances to request the three year period to be waived.

Further, if that waiver is granted, the party which has been determined to have imposed a DST / RSM contrary to the terms of the MLC should refund the amounts collected for any period for which it also was entitled to receive an Amount A allocation, even retrospectively. The party also should be required to grant a refund of the DST / RSM under the procedures established in Annex H paragraph 10(a)(i) for measures in effect on the date the MLC is opened for signature, for the period between that date and the date of the Conference of the Parties decision. There is no policy reason to allow this double taxation in either case.

The relatively mild sanctions proposed in the MLC for a breach of the obligation to remove DSTs / RSMs could be interpreted to imply that the choice between a DST or Amount A is a legitimate policy choice for a jurisdiction. While we do not believe that the IF intended to signal to countries that it is appropriate to choose between collecting Amount A or imposing a DST, we are concerned that some countries may improperly interpret the MLC in such a fashion. We believe that all elements of the MLC should be focused on removing those items which destabilize the international tax framework, not

present them as a neutral policy choice.

Subnational Taxes

We endorse the inclusion of subnational DSTs within the scope of review for withdrawal pursuant to Annex H, paragraph 11. We suggest that an Annex J be added to list those in effect at the time of the signing of the MLC. We endorse the proposal in Annex H paragraph 14 that the Conference of the Parties will publish its decisions whether a subnational tax is a DST / RSM along with the report of the party as to its efforts to have the tax removed, in order to bring transparency to that process. Recognizing that in federal states, there may be limits on whether the federal state can compel the subnational state to change its tax laws, we encourage the U.S. to advocate for as strong a measure as possible to ensure the removal of such taxes in these circumstances.

Significant Economic Presence Nexus Rules

The introduction by some jurisdictions of significant economic presence ("SEP") nexus standards has contributed to the destabilization of the international tax framework. These rules duplicate Amount A, in that the only purpose of such rules is to bring into the market state taxing jurisdiction some part of the profits of the non-resident enterprise making sales into that state.

Accordingly, we were pleased to see that that SEP rules have been partially included in the restabilization framework. We certainly agree that any jurisdiction claiming an Amount A allocation should not also claim a share of offshore profits through a SEP nexus rule. We believe, however, that any SEP nexus rules which persist after the introduction of Amount A will remain a destabilizing element, as they do not comply with the agreed division of taxing rights between source and residence states as reflected in Pillar One. The purpose of SEP rules is to bring a nonresident enterprise's tax base into the source country by reference to digital transactions. This is exactly the same purpose as underlies DSTs. Accordingly, we believe that SEP rules enacted by MLC parties should be treated like DSTs / RSMs, and withdrawn for all taxpayers.

MDSH Mechanics

As background, SVTDG provided commentary last year in response to the OECD's public consultation, observing the general ineffectiveness of the interim design of the MDSH. SVTDG members now commend the partial inclusion of domestic withholding taxes in the MDSH mechanics. However, we also observe that the introduction of tax adjustments in the measurement of residual profits (in both the MDSH and EODT), otherwise further detracts from the utility of the MDSH. The relative significance of these countervailing changes will vary from company to company, but we believe, that on balance the various limitations in the proposed MDSH calculations will cause this element to fall short of the goal of preventing double taxation in the market state of profits beyond routine marketing and distribution profits.

The proposed mechanics provide a guaranteed profit floor to the market state based on the higher of the threshold return on depreciation and payroll (which we understand is based on an assumed 10% profit margin, a margin that is well beyond that attributable to only routine activity) or 3% of revenue. Those guaranteed floors provide very generous returns to any hypothetical routine activity. Based on our Members' long experience with transfer pricing matters, 10% return on sales does not reflect the dividing line between routine and non-routine activity.[5] The alternative measure of 3% of revenue for

[5] We assume the 10% benchmark for the MDSH was chosen as a parallel to the separate and different purpose to define Amount A as profits over a 10% of revenue return. The 10% threshold for Amount A purposes reflects a

low function, low risk entities similarly produces a guaranteed floor that certainly exceeds normal margins for low function, low risk distribution activity.

Even at low rates, a gross-based withholding tax typically claims as tax for the market state a large percentage of the nonresident's profit. We were pleased to see that the delegates have now agreed to integrate that allocated taxable profit into the MDSH mechanics. We believe that a more appropriate result would have been to treat 100% of the notional profit taxed by the withholding tax as profit taxed by the market state for MDSH purposes. We appreciate that the adjustments in Article 5(2)(d) are the result of a political agreement, but they undermine the goal of not rewarding jurisdictions with further taxation rights which already tax residual profits under Amount A.

We note that three countries have registered objections to portions of this formula. We also observe that the structure and detail of Amount A already include many compromises. Delegates have made many concessions to developing countries, such as lower nexus thresholds in Article 8, the generous definition of Amount A Profit in Article 2(d) arising from the 10% and 25% figures, higher returns to developing countries in connection with Amount B, and the allowance for elective binding dispute mechanisms in Article 36. SVTDG members consider that in light of those compromises, there is no reason to further dilute the effect of the MDSH.

The diluted impact of withholding taxes in the MDSH calculation presents special risks for the U.S. The U.S. treaty network remains less developed than those of many of its trading partners. Accordingly, more countries are able to impose domestic withholding tax on payments to U.S. companies compared to payments to residents of other jurisdictions, as they are not constrained by treaty from doing so. As is evidenced by the recent revisions to Article 12 and the introduction of Articles 12A and 12B to the U.N. Model Convention, many countries consider imposing withholding taxes on cross-border payments for software products, technical service fees, and automated digital services to be good tax policy. The current definition of DSTs / RSMs in the MLC would seem to not preclude those taxes, as the jurisdiction would not argue they are outside the scope of their tax treaties. That opens the possibility that a withholding tax on automated digital services (for example) could be imposed on payments to U.S. companies, the jurisdiction would retain its entitlement to tax Amount A, and the withholding tax would only be partially integrated into the MDSH mechanism. We note that a senior tax official from Argentina recently noted the possibility that Argentina might consider a withholding tax on payments for automated digital services.

This scenario also emphasises the reason that the U.S. should continue to work to expand the definition of a DST / RSM to something closer to the SVTDG's prior recommendation to identify destabilizing element of proposed taxes, including examining whether a principal policy purpose is to tax nonresident digital service suppliers.

MDSH Threshold

We are concerned that the €50 million profit threshold in Article 5(1)(b) eliminates far too many market states from application of the MDSH. An entity earning 5% RoS, for example, is clearly earning a profit level beyond routine distribution returns, in which case the MDSH should in principle apply. An enterprise located in the market state would have to have local revenue of over €1 billion to exceed €50 million profit. That excludes far too many entities even for the largest groups. Even the very largest

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political compromise simply to establish the mechanics of the Amount A calculation. The MDSH, in contrast, should be based on a more principled economic dividing line between routine and residual profit. The elimination return based on a 10% of revenue benchmark exceeds routine profit in essentially all cases.

groups that would be subject to Amount A would have a very small number of countries in which this threshold would be met.

Accordingly, the SVTDG suggests that this threshold should be considerably reduced. We note in comparison the very low €1 million and €250,000 nexus thresholds in market states for Amount A entitlement. The €50 million threshold will limit the application of the MDSH even more when the consolidated gross revenue threshold for Amount A reduces to €10 billion, as the marketing entities in those smaller groups will have proportionately less revenue.

Autonomous Domestic Business Exception

SVTDG members applaud the introduction of the autonomous business exception. The purpose of Amount A is to reallocate to a market state some portion of profits derived from cross-border transactions. As a response to market state desires for more taxation rights over profits arising from sales by nonresidents into the market state, in principle Amount A should exclude all profits which arise entirely from production and sale in an entity's domestic market. We believe that a domestic business exception is in the best interests of the United States, since many U.S. businesses earn higher profit margins inside the U.S. than overseas, and there is little policy justification for the United States to share those profits with other jurisdictions, as those profits do not arise from exports in cross-border transactions.

We are disappointed, however, to see the very narrow definition applied to this exception, which fails to recognize differing profit margins across business units within companies. In general, U.S. businesses are more globally integrated than groups headquartered in other jurisdictions, so the limits on cross-border transactions in the definition will take many U.S. businesses out of scope. This will create a disproportionate impact compared to countries whose enterprises tend to expand out from their home market at a much slower pace than U.S. companies. SVTDG members would be concerned if the autonomous domestic business exception generally is not available to U.S. groups, but instead results principally in exclusion from Amount A of major enterprises of other large economies.

We also are disappointed that the exception, as currently drafted, would not seem to apply to groups with a mix of autonomous and non-autonomous businesses in the same country, as the test is applied at a country level. To avoid situations where the Amount A allocation is grossly distorted, we suggest consideration be given to excluding autonomous domestic businesses from Amount A reallocation where these separately disclosed business lines represent a certain percentage of sales and have margins that vary meaningfully from the overall margins of the group.

Amount B

SVTDG members support a successful implementation of Amount B. We were encouraged by recent comments from Treasury officials that the U.S. considers a robust Amount B as a necessary complement to Amount A. Successfully implementing a reasonable Amount B plays its own important role in stabilizing the international tax framework. As many commenters noted in submissions in the Amount B public consultation, the proposed Alternative B acts at cross-purposes to the stabilization goal, as it introduces subjectivity into a process which is designed to reduce, not increase, areas of dispute. As we have advocated in the past, we strongly encourage the expansion of Amount B to cover services, since the current framework does not include an adequate stabilizing mechanism for transfer pricing disputes for services companies. We refer to our Comment Letter on Amount B dated September 1, 2023, and repeat those comments here.

Many of the concerns noted above in the design of the MDSH would be alleviated if companies in scope of Amount A were in all cases eligible for Amount B. Moreover, Amount B returns should be used to establish the MDSH threshold. Neither is the case in the draft MLC. We nevertheless encourage the conclusion of the work on Amount B, as an important element in stabilizing the broader international tax framework, including recognition of its importance to many developing countries participating in the Inclusive Framework. We would also strongly encourage that work continue immediately beyond the initial Amount B design stage to explore further broadening of its scope, and perhaps further consideration of its incorporation into the MDSH design in the future (i.e. before the scope of Amount A is expanded upon the reduction of the revenue thresholds). The IF should announce and implement a plan to expand the scope of Amount B.

Coordination Between Pillar One and Pillar Two

An ordering rule is needed between the Amount A allocation of taxing rights and the Pillar Two determinations of effective tax rates under the GloBE rules. We believe that it is clear that taxes imposed on Amount A allocations should be determined before the GloBE calculations are performed under Pillar Two. Pillar Two is meant to allow for a top-up tax after all other taxes have been determined. Accordingly, the Pillar Two calculations should be done after taxes imposed on Amount A allocations have been determined.

Further, the taxes paid to the market states exercising their rights to tax Amount A should be allocated for Pillar Two purposes to the entities which are obliged to give relief for the Amount A taxes. If more than one entity is required to give relief, the taxes should be apportioned among those relieving entities. Amount A only reallocates taxing rights over the relieving entity's income; it does not reallocate group income to another entity. The Amount A tax is a covered tax and should be included in the relieving entity's jurisdictional ETR to avoid distortions.

The Model Rules Commentary supports Amount A applying before Pillar Two and aligning market jurisdiction tax with related GloBE income. See 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. The treatment of Pillar One taxation will be further addressed through Administrative Guidance to be developed as part of the Implementation Framework.

The treatment for Pillar Two purposes of the Amount A tax as a tax paid by the constituent entity that is obliged to provide relief under Amount A should be clarified in further Pillar Two administrative guidance.

Certainty Procedures

SVTDG members applaud the introduction of a mandatory binding resolution process for amounts related to Amount A, although we find it unfortunate that many developing countries are given the choice whether to be subject to the mandatory binding process under Article 36. We also encourage Treasury to continue to negotiate or renegotiate U.S. tax treaties to include mandatory binding

arbitration provisions. In the experience of SVTDG members, those provisions provide material improvements in certainty for taxpayers compared to treaties where the MAP Article does not provide for a backstop of a binding resolution process for matters covered by the treaty.

SVTDG members continue to have concerns over some aspects of the review panels for Amount A. The MLC allows a single jurisdiction to cause a referral to a determination panel by objecting to the conclusions of a review panel. We suggest that agreement by some greater number of parties should be required before the work of a review panel is disregarded. We also remain concerned that Article 28 provides that the determination panels will include independent experts as panellists. We continue to believe that panel members should be limited to active government officials.

Domestic Legislation

We note that if the U.S. agrees to implement the MLC, U.S. domestic law will need to be amended to allow the U.S. to tax inbound Amount A allocations. The same will be true for other parties to the MLC. We also note the provisions in Articles 43, 50 and 51 governing withdrawal by a party or termination of the MLC.

Domestic law amendments which create domestic nexus rules to allow taxation of Amount A allocations should be enacted subject to the condition that the MLC remain in effect for that jurisdiction. If the MLC no longer applies to that state, but the expanded nexus rules remain in place, the result essentially could be equivalent to a SEP nexus rule, with no treaty in place to preclude the application of that extraterritorial tax.

Relieving State Mechanics

Article 12 provides that relief for tax on Amount A shall be allowed in the relieving jurisdiction according to the domestic law of the party. U.S. taxpayers will be affected by the double tax relief rules in both the United States and countries where CFCs operate, as the double tax relief granted in a CFC jurisdiction will affect the foreign taxes paid element of the section 904 limit in the GILTI basket. As a matter of principle, the U.S. should apply its domestic rules to ensure that the mechanics of relief granted either to a U.S. domestic taxpayer or to a CFC both (i) completely relieve the effect of the foreign tax on Amount A, and (ii) do not diminish the allowable foreign tax credits available to the group for foreign taxes other than taxes on Amount A in any section 904 basket absent the application of Amount A and the increased foreign tax. This could be accomplished for example by creating a separate Section 904 basket, without any limiting factors on the relief (e.g., FTC haircut, foreign source income limitations, expense apportionment, etc.)

We also note that the mechanics of the relieving mechanism could result in double taxation where there is insufficient capacity among signatory states to absorb double tax relief for the full Amount A allocations made to signatory states. One case where this could arise, for example, is when unapplied relief obligations of a relief entity expire after the three year period described in Article 12(4). We suggest that a general provision be included in the MLC to achieve symmetry to ensure that amounts cannot be allocated to a taxing state without corresponding relief granted by a relieving state. That may require providing for refund claims from states which had taxed an allocated Amount A share that did not result in double tax relief.

Pillar Two R&D Credit

On a separate note, SVTDG members are extremely encouraged by the recent statements by U.S. officials that the Pillar Two rules should equalize the treatment of the U.S. R&D credit with other country

incentives, including refundable research credits. We hope that the IF will confirm this outcome and the OECD will release implementing guidance in the near term.

Conclusion

As detailed above, we recognize that this revised draft MLC includes a number of improvements from last year's interim design proposals, taking into account input from the business community. At the same time, there have been other changes made that may further detract from the effectiveness of safeguards in the design, including importantly the MDSH. We further recognize that computationally heavy design features and many other elements in design were heavily negotiated amongst the countries. It bears emphasis that, improvements notwithstanding, SVTDG members believe that the result will produce unexpected outcomes at a company level that may not be consistent with the stated goals of Amount A. This needs to be clearly understood at the outset by all parties that may be affected.

Considering the likely alternative of further unilateral measures and other actions that may be taken by countries in lieu of a multilateral solution, we nonetheless encourage U.S. Treasury to remain engaged in the process to achieve a comprehensive conclusion of **all** remaining final design features, in close collaboration with U.S. Congress. Specifically, we would like to highlight the following as areas requiring particular emphasis:

- A conclusion on the final MLC text that reflects the U.S. view on the final areas of reservation in the draft MLC;
- A conclusion of the final MLC text that includes a firm commitment and plan by the Task Force for the Digital Economy ("TFDE") to continue work to conclude the initial scope of Amount B, and to continue work to expand the scope of Amount B on a reasonable timeline;
- Confirmation on the interaction between Pillars 1 & 2 in a manner consistent with the Pillar 2 commentary;
- Express commitments by other countries to extend the DST moratorium through 2025;
- Further work to improve the scope and definition of DSTs and RSMs;
- A fresh analysis of the relieving state mechanism to assess potential gaps in achieving full double tax relief, especially in view of the real possibility that there will be insufficient capacity among signatory relieving jurisdictions to absorb the required relief and that one or more major relieving jurisdictions may not be a signatory to the MLC;
- Bringing the Amount B work to a successful conclusion, including covering services; and
- Recognition that US foreign tax credit regulations will need to be further amended to account for Amount A tax effects.

* * *

We applaud the Treasury for conducting this public consultation, and look forward to Treasury advancing these points in the ongoing negotiations.

Sincerely,

/s/ Robert F. Johnson
Co-Chair, Silicon Valley Tax Directors Group

Appendix -- SVTDG Members

10x Genomics, Inc.
Accenture
Activision Blizzard, Inc.
Adobe Inc.
Agilent Technologies, Inc.
Airbnb, Inc.
Align Technology, Inc.
Alphabet Inc.
Amazon.com, Inc.
Ancestry.com
Apple Inc.
Applied Materials
Aptiv PLC
Arista Networks
Asana, Inc.
Atlassian
Autodesk, Inc.
Blackhawk Network, Inc.
BMC Software, Inc.
Broadcom Inc.
Cadence Design Systems, Inc.
Chegg, Inc.
Cisco Systems, Inc.
Citrix
Confluent, Inc.
CooperCompanies
CrowdStrike Holdings, Inc.
Dell Technologies
Dolby Laboratories, Inc.
DoorDash
Dropbox, Inc.
Dynatrace
eBay Inc.
Elastic N.V.
Electronic Arts
Expedia Group, Inc.
Faire Wholesale Inc
Flex Ltd.
Forte Labs, Inc.
Gen Digital, Inc.
Genentech Inc.
Genesys Cloud Services
Getaround
Gigamon Inc.
Gilead Sciences, Inc.
GitLab Inc.
GlobalLogic
GoPro, Inc.
Hewlett Packard Enterprise
HP Inc.
Indeed
Informatica
Ingram Micro, Inc.
Instacart
Intel Corporation
Intercom, Inc.
Intuit Inc.
Intuitive Surgical
Jazz Pharmaceuticals
Keysight Technologies, Inc.
KLA Corporation
Lam Research Corporation
Lattice Semiconductor Corporation
Liftoff Mobile, Inc.
LiveRamp, Inc.
Marvell Technology, Inc.
Match Group
Meta Platforms, Inc.
Microsoft Corporation
Momentive.ai
Netflix, Inc.
Netskope
Nutanix Inc.
NVIDIA Corporation
Okta
onsemi
Oracle Corporation
Ouster
Palo Alto Networks
PayPal Holdings Inc
Pinterest
Protocol Labs
Pure Storage, Inc.
Reddit Inc.
Ring Central, Inc.
Robinhood
Rubrik Inc.
salesforce.com
Seagate Technology
Semtech Corporation
SentinelOne
ServiceNow
Snap Inc.
Snowflake Inc.
Sophos
Splunk, Inc.
Synopsys, Inc.
Tesla, Inc.
The Walt Disney Company
Trimble
Twilio Inc.
Uber Technologies
UiPath
Unity Technologies
Verifone
Veritas Technologies
Visa Inc.
VMware, Inc.
Western Digital
WideOrbit
Workday Inc
Yahoo, Inc.
Yelp Inc.
Zillow Group, Inc
Zoom Video Communications, Inc.
Zoominfo Technologies Inc.
Zscaler, Inc