

Position Paper

Tax Challenges arising from Digitalisation – Inclusive Framework on BEPS: Public Consultation

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Summary

In October 2020 the Inclusive Framework on BEPS in cooperation with the OECD published the outline of a new framework for the taxation of multinational enterprises. The framework consists of a mechanism for reallocating taxing rights between countries ([Pillar One](#)) and a set of rules to ensure a global minimum level of corporate income tax ([Pillar Two](#)). The proposals, which are laid down as Blueprints for a prospective taxation framework, are designed to address the tax challenges arising from the digitalisation of the economy.

We welcome the efforts of reaching an international consensus for the taxation of digitalised services rather than setting up different national rules in every country. But it must be ensured that after reaching an international consensus all national regimes with a similar scope are abolished.

In the light of the rationale of the project (addressing tax challenges arising from digitalization) and seeing the objective of replacing digital services taxes on a national level the scope of Pillar One should be further reduced. Thus it should focus on activities effectively untaxed in market jurisdictions so far. Consequently the scope of Pillar One is to be specified to provide for more clarity regarding businesses in and out of scope. Automated digital services (ADS) and consumer facing businesses (CFB), which are purely delivered within a B2B-transaction, should be out of scope as they were never part of the concerns regarding the taxation of the digitalization of the economy. For example, application software delivered by a cloud service is a business input as well as the sale of “industrial software” that is used for simulating production processes, production machines and industrial infrastructure (the “Industrial Internet of Things”). Moreover we suggest to carve out local businesses from the scope of Pillar One as far as they require a local infrastructure and thus can be taxed adequately according to the rules for permanent establishments.

Pillar Two has to be aligned with the GILTI-regime in the United States. In addition, the rules within Pillar Two should be further simplified.

Bitkom
Bundesverband
Informationswirtschaft,
Telekommunikation
und neue Medien e.V.
(Federal Association
for Information Technology,
Telecommunications and
New Media)

Thomas Kriesel

Head of Taxes

P +49 30 27576-146
t.kriesel@bitkom.org

Albrechtstraße 10
10117 Berlin
Germany

President
Achim Berg

CEO
Dr. Bernhard Rohleder

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1. General remarks

According to the statements in the Blueprints and accompanying documents the top priority of the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) has been to develop a solution to the tax challenges of the digitalisation of the economy. Due to the fact that such a solution has been missing so far many countries put in place digital services taxes on a national level, which differ widely with respect to scope, tax rates, tax base, thresholds and affected business activities. The withdrawal of these unilateral measures must be pre-condition for agreeing on Pillar One. This is a key concern for businesses in order to ensure that groups are not subject to double or even multiple taxation.

One of the main starting points of the initiatives on BEPS is the opinion that digital business models and digital services cannot be sufficiently covered by traditional taxation rules any longer. Though we do not share this opinion we acknowledge the need of market jurisdictions to raise their share in international tax revenue. But if one country is entitled to a higher share of tax revenue other countries will have to accept downturns in order not to end up in double or even multiple taxation or in tax increases detrimental to the global economy. This conviction does not seem to be sufficiently prevalent within the Inclusive Framework.

Moreover many questions still are not satisfactorily answered, such as scope, nexus, minimum tax-rate, rule coordination or how to establish tax certainty by binding dispute resolution mechanisms.

2. Key principles for international taxation

Attributing more taxing rights to market jurisdictions cannot be the only purpose of a new taxation system. The interests of businesses and the feasibility of the system have to be taken into account likewise. Thus the design of new rules for international taxation must observe the following objectives:

- Preventing double or even multiple taxation of the same income: for this purpose the jurisdictions have to reach a common understanding on the rules of allocating profits and taxing rights as well as on the interpretation of these rules to make sure that profits may only be subject to tax in one country; further, some binding tax dispute prevention and resolution regulations need to be agreed;
- Taxing profits only, not turnover: taxation must not exceed the profits taxed and losses have to be recognized for taxation purposes;
- Promoting tax certainty: enterprises must be able to calculate tax burdens before starting business in a jurisdiction and the calculated tax must be reliable;

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- Reasonable effort for taxpayers to comply with the new rules: the goal of implementing new taxation rules must be reducing compliance costs for businesses; so the need for collecting data and for reporting for taxation purposes has to be limited;

These goals have been reiterated numerous times and also have been accorded to by the OECD and the Inclusive Framework. Nevertheless their importance for businesses, especially prevention of double taxation, tax certainty and straightforwardness of taxation rules cannot be emphasized strongly enough. These goals have not been reached satisfactorily so far by the Blueprints. So the efforts in this respect have to continue.

3. Reallocation of taxing rights (“Pillar One”)

Pillar One is aiming at reallocating taxing rights in favor of countries where a multinational enterprise is doing business without using a physical presence in the country (market jurisdiction). In order to achieve this, the residual profit of a multinational enterprise is split into an Amount A and an Amount B. While traditional transfer pricing rules (with some adjustments) are applied to Amount B, a completely new mechanism has been developed to identify, calculate and allocate Amount A.

3.1 Scope and Nexus

The initiative of “Pillar One” is designed to deliver a taxation framework matching the digitalising economy. Although this reasoning is repeated consistently it is not thoroughly reflected by the design of the rules. So it is difficult for many multinational enterprises (MNE) to evaluate whether they might fall under the scope of Pillar One. The delimitation of CFB as foreseen in the Blueprint appears as a rather artificial differentiation which does not reflect the reality of business lines in most companies. Considering the original intention of the OECD-initiative, that is to ensure a “fair taxation of the digitalisation of the economy”, for ADS we propose focusing on business models being subject to definitions of digital services taxes regulations. Further, it should be considered that B2B rendered ADS were never subject to the discussions regarding taxation. For example, application software delivered by a cloud service is a business input as well as the sale of “industrial software” that is used for simulating production processes, production machines and industrial infrastructure (the “Industrial Internet of Things”). Therefore, both for ADS and CFB B2B deliveries and services should be out of scope.

Considering the serious problems which companies will face in complying with Pillar One we propose to foresee a further carve out of the scope. Thus an enterprise should be exempted from being taxed according to the rules of Amount A in a jurisdiction, if it proves a considerable local business within this jurisdiction. Some examples for such carve outs are

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given on page 55 of the Pillar One Blueprint: telecommunication, electricity generation and others. Carving out these services is justified, because such services typically require a degree of local infrastructure and are subject to the taxation rules for permanent establishments. Similar exemptions should also be applicable for MNE of other industries if the use of respective local infrastructure can be proofed.

3.3 Sourcing

In order to identify the revenues in a market jurisdiction which are subject to Amount A sourcing rules are to be set up. The sourcing largely is determined by the place of consumption. The gathering of data for this purpose creates significant challenges for enterprises, which for some businesses (e.g. for cloud, sales of products to 3rd party distributors) may be even unrealizable. So the allocation of taxing rights and profits should be based on information and documentation that is already available. It should not lead to a further increase of the already heavy burden of documentation and administration requirements. Thus, indicators as laid down in the EU VAT regulations for electronically supplied services might be taken as a basis. Allocation provisions should also consider data protection regulations (GDPR) that might restrict access to certain information.

Besides businesses should be provided with a certain flexibility depending on information they have available. For example, for VAT purposes normally the customer's billing address and/or country of residence is to be identified, as well as the default ship-to address. Moreover the home-country of the payment service provider and the country of IP address-registration regularly are known facts. Whereas businesses generally do not collect data based on the location of end users/viewers, and a lot of work in terms of changing internal systems would be required and data protection provision would have to be overcome to be able to do so.

It should be clear that related party transactions are scoped out of the revenue measurement.

3.4 Expenses

We acknowledge the efforts which have been undertaken to facilitate the handling of the new rules and to reduce costs and efforts for the taxable entities. Nevertheless further simplification is necessary because the rules inflict partly unaccomplishable duties on the companies. A possibility to reduce expenses which companies have to take only for taxation reasons is to base taxation on data which already is collected by the enterprises for accounting purposes. The necessary data must be readily accessible for both taxpayer and

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tax authority rather than information that has to be prepared specifically to implement these rules. Readily available data is to be found:

- in published and audited global consolidated financial statements; or
- in published and audited financial statements by segments.

3.5 Dispute resolution

The best way of reducing taxation disputes is to avoid them by clear rules which are harmonized globally. Nevertheless, disputes will never be avoided completely. We support the proposed panel arrangement and staged approach to dispute prevention/resolution to simplify the audit and review process.

Anticipating the fact that the timing of adoption by jurisdictions will vary because of differences in parliamentary procedures and acknowledging that system changes are likely inevitable, agreement should be reached to allow sufficient time for the adoption and administration of the new system in a manner that does not increase disputes or result in multilayer taxation.

4. Minimum Taxation (“Pillar Two”)

4.1 Further Simplification

The design of the Pillar Two system as outlined in the Blueprint is very complex. The Blueprint contains a number of areas that would create a significant amount of additional compliance-work for companies. We would anticipate that many countries will have difficulties in interpreting and applying these rules in practice. We would encourage the OECD to consider ways in which these rules can be simplified.

For example, the requirement for jurisdictional blending creates a burden on groups to effectively create mini-consolidations for every country in which they operate and maintain multiple sets of books, which is not something that groups generally do today. Considering safe harbors based on global financial segment ETRs, or even allowing groups to apply the rules at an entity level (by taxpayer choice) may create a simpler approach. The rules should leverage existing financial information that groups already have available and should provide appropriate flexibility in this area.

The approach to IIR credits and timing differences appears to be very complex to apply for MNE groups. We would recommend that using deferred tax balances would be a more

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straightforward approach since those numbers are largely already available and achieve a similar outcome.

Adjustments based on different local tax laws may create ambiguity, complexity and distortive effects (for example, on share-based compensation). The approach should be simple to administer and uniform across all countries, otherwise it will lead to inevitable disputes.

4.2 Coexistence with existing rules

Pillar Two does not yet provide an indication how the rules for global minimum taxation will co-exist with existing rules with a similar rationale, especially GILTI. GILTI has a policy objective consistent with Pillar Two: taxing foreign earnings that are otherwise subject to little or no tax. Securing GILTI-grandfathering might be helpful in leveraging wider US support to an overall agreement.

Bitkom represents more than 2,700 companies of the digital economy, including 2,000 direct members. Through IT- and communication services alone, our members generate a domestic annual turnover of 190 billion Euros, including 50 billion Euros in exports. The members of Bitkom employ more than 2 million people in Germany. Among these members are 1,000 small and medium-sized businesses, over 500 startups and almost all global players. They offer a wide range of software technologies, IT-services, and telecommunications or internet services, produce hardware and consumer electronics, operate in the digital media sector or are in other ways affiliated with the digital economy. 80 percent of the members' headquarters are located in Germany with an additional 8 percent both in the EU and the USA, as well as 4 percent in other regions of the world. Bitkom promotes the digital transformation of the German economy, as well as of German society at large, enabling citizens to benefit from digitalisation. A strong European digital policy and a fully integrated digital single market are at the heart of Bitkom's concerns, as well as establishing Germany as a key driver of digital change in Europe and globally.