Comments of the G-24[1] on the ongoing work under G20/OECD Inclusive Framework under BEPS on the work for Addressing tax challenges arising from the Digitalisation under Pillar One and Pillar Two

General Comments

1. G-24 appreciates the efforts by the Steering Group of Inclusive Framework in working towards a consensus solution for addressing the tax challenges arising from digitalisation during these challenging times. It also puts on record its appreciation of the technical support given by OECD Secretariat to the Steering Group and various working parties in this respect.

2. G24 notes the use of Outline of the architecture of a unified approach to Pillar One document approved by the G20/OECD Inclusive Framework on BEPS as the basis for the negotiation of a consensus-based solution by the end of 2020. We welcome the fact that this document recognises that allocation of taxing rights should no longer be anchored to physical presence and that profits should be allocated to market jurisdictions.

3. G-24 favours rules that are fair and simple, and are capable of being implemented effectively by developing countries. The agreed solution should be flexible enough in capturing new/emerging business models, as these are under constant change. The solution should take into consideration the capacity constraints of the developing countries. It is imperative that all jurisdictions especially developing countries understand what they are committing and agreeing to.

4. Recognising the need for certainty in tax matters and the fact that new rules are being designed, G-24 supports focus on dispute prevention rather than on dispute resolution. There is a need to consider dispute prevention right from the design stage and have rules that are fair, simple and are capable of being implemented effectively particularly by developing countries. The outcome of a focus on dispute prevention will be fewer disputes and less uncertainty.

5. The African members of the G24 consider that the present time line for completing the work by the end of 2020 is ambitious especially given the current COVID -19 situation and therefore, the deadline should be extended to mid of 2021.

[1] This note was prepared by the G-24 Working Group on Tax Policy and International Tax Cooperation, and is being submitted on behalf of the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development (G-24). This note represents the views of all member countries, out of which Argentina*, Brazil*, Colombia*, Cote D'Ivoire*, Egypt*, Gabon*, Haiti*, India*, Kenya*, Mexico*, Morocco*, Nigeria*, Pakistan*, Peru*, South Africa*, Sri Lanka*, and Trinidad and Tobago* (www.g24.org) are also members of the BEPS Inclusive Framework.

Specific Comments

Pillar One

6. G-24 understands that for Amount A under Pillar One, a number of thresholds are proposed to ensure that compliance and administrative burdens are proportionate to the intended benefits. The process of determination of the thresholds should be inclusive and take into consideration the concerns of small developing economies. G-24 requests the Steering Group to consider thresholds lower than EUR 750 million[2] so that developing countries can benefit from the proposed new taxing right. Revenue collection contributes to national treasuries, which finances national development plans and in turn works towards reducing poverty especially in developing countries. Further, for the sake of simplicity, it is important that the number of thresholds be kept to bare minimum and merged where ever possible. The global revenue threshold and activity test can be merged to only one threshold to reduce compliance burden and for the sake of simplicity. A deminimus threshold of allocable profit under amount A may be considered to further reduce the compliance and administrative burden.

7. Under Amount A, for determination of nexus of consumer facing business (CFB) in addition to the revenue threshold , *plus factors* such as the existence of a physical presence of the MNE in the market jurisdiction or targeted advertising directed at the market jurisdiction are proposed. G-24 is of the opinion that these factors will introduce a layer of complexity and it would lead to disputes. Understanding that some jurisdictions are in favour of plus factor tests and for the sake of consensus, we propose that if plus factors are introduced for testing the nexus of consumer-facing business (CFB) then these should be objective. Some of the factors that can be considered and are connected with the in-scope revenue are (i) presence of dedicated third party logistics service providers who ensure clearance of goods, its transport and delivery and (ii) after sales service provider for goods in a jurisdiction. The proposed indicators can serve as additional indicators for engagement with the market jurisdiction in case of sale of tangible goods.
8. G-24 is not in favour of the adoption of the temporal requirement for three years for determining nexus for Amount A, which is presently under discussion. Temporal requirements add a layer of complexity. Any temporal requirement spanning more than one year is unfair as jurisdictions are required to share pre-regime losses but share profits only after meeting the revenue threshold for at least three years (as per present proposal). The nexus rule of Amount A is based on indicators of a significant and sustained engagement with market jurisdictions.

[2] As proposed in paragraph 35 of the IF document on Outline of the Architecture of a Unified Approach on Pillar One.

The primary test of this significant and sustained engagement is the in-scope revenue. For CFB *plus factor* are being explored as additional nexus tests. Looking at the scope, it is clear that there cannot be one off transactions for the establishment of local nexus (which is yet to be decided).If some jurisdictions have concerns then as an alternative *number of transactions in a year* can be explored as an objective indicator for significant and sustained engagement along with in-scope revenue for CFB.

9. G-24 notes that there are differences in positions of jurisdictions on digital differentiation[3]. It may be recalled that genesis of the present work for addressing tax challenges arising from digitalisation is the inadequacy of present nexus and profit attribution rules to provide a solution. The Unified approach while finding a consensus solution proposes only allocation of Amount A, which is a portion of deemed residual profit, to a remote sale market jurisdiction. For this remote sale, the MNE has to carry out marketing and distribution activities and the renumeration for such activities needs to be taxed in the market jurisdiction. G-24 finds it illogical and inappropriate that an enterprise will have a taxable nexus in a market jurisdiction but would pay tax only when it earns non-routine profit. An enterprise engaged in automated digital services (ADS), does marketing of its product, distributes its products say TV shows or movies, collects payments from customer and addresses customer grievances. All these activities, which are in the nature of baseline distribution and marketing activities can be performed remotely. It is therefore quite unfair (and ironical) to deny taxing rights in respect of such activities to a market jurisdiction on the ground that these are not performed physically when the very purpose of the discussion is to address precisely this problem i.e., the ability of businesses to operate remotely due to digitalisation. Therefore, of the three options given in the Outline, the G-24 finds the third option -- return for deemed performance of certain activities like baseline distribution and marketing of digital goods and services -- as the most appropriate solution. This return should be analogous to amount B. This will also lower the incentive for an MNE to shift such baseline distribution and marketing activities, which can be performed remotely, to a low tax jurisdiction. Needless to mention, a jurisdiction where the enterprise providing services is entitled to B as such baseline distribution and marketing activities are performed physically, then that jurisdiction would not be entitled to any additional amount.

10. G-24 urges the Steering Group to consider the economic circumstances of developing countries, such as high inflation rates and high interest rates that often translate into high profit margins (though relatively much less profit in absolute terms), while designing the rules for elimination of double taxation. It is important

[3] As discussed in paragraph 4 of the IF document Statement by the Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges arising from the Digitalisation of the Economy.

to look at these indicators while identifying the relieving jurisdiction so that profitability is not a preferred criteria for double taxation elimination.

11. G-24 does not favour the sharing of pre-regime losses. Further, we are opposed to the idea of sharing of deemed residual profits. G-24 also does not favour carry forward of losses for an unlimited period.

12. G-24 welcomes the efforts of the OECD Secretariat to find alternative to arbitration. We support the idea of first developing the new multilateral early certainty mechanism for Amount A and are not in favour of extending this mechanism to bilateral transfer pricing and permanent estabilishment (TP /PE) disputes. We consider that sufficient work has already been undertaken on dispute resolution under BEPS Project and we should allow some time for these measures to stabilise, and the 2020 Action 14 peer review is a good opportunity to strengthen the existing measures by identifying areas of frequent disputes and working on them.

Pillar Two

13. G-24 supports the inclusion of Subject to Tax Rule (STR) as the primary rule under Pillar Two. STR is a simple transaction based rule and hence should be the first one to apply. STR is beneficial to all the jurisdictions and seeks to address the remaining BEPS issues especially where, due to bilateral tax agreements, one country gives the other the right to tax the income and the other jurisdiction fails to tax the income up to the minimum level. It is a mirror of the income inclusion rule (IIR) for the source countries -- both developed and developing.

14. G-24 is not convinced of the need for a threshold in Income inclusion rules as every jurisdiction has the right to tax its domestic companies and this is recognised principle in international tax law. This has now been introduced in the form of provision in the Model Tax Convention in the form of Article 1(3). A similar minimum tax rule enacted by the United States (GILTI) does not have any threshold. We, therefore, believe that the issue of threshold for IIR, if any, should be left to domestic legislation.