

Comments of the G-24¹ on the Pillar One and Pillar Two proposals being discussed by OECD/G20 Inclusive Framework on BEPS, 17 May 2021

1. G-24 appreciates the efforts by the G20/ OECD Inclusive Framework (IF) in working towards a consensus solution for addressing the tax challenges arising from digitalisation during these challenging times. This Note draws on the G-24's comments sent to the Inclusive Framework in December, 2020, specifically with reference to the Inclusive Framework blueprint report released in October 2020 and the recent proposals from the USA to revise the blueprint proposals.
2. G-24 has always favoured rules that are fair, 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. For ensuring a consensus agreement, it is important that the process is truly inclusive and the concerns of the developing countries and the potential unintended consequences of the new rules are adequately addressed. 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.
3. G-24 notes the recent momentum imparted in the negotiations for finding a solution for tax challenges arising from digitalisation, by the proposal from US suggests a simplified approach, whereby all types of MNEs, with some carve outs, will be subject to the scope of Pillar One using a quantitative filter. As per this proposal, instead of scoping by business activity as discussed in the Blueprint², a revenue and profit margin threshold would apply to ensure that only the limited number of largest and most profitable corporate giants (limited to 100 top MNEs) would be in scope for Amount A.
4. G-24 is of view that the proposed scope of the Pillar 1 limited to top 100 MNEs will result in smaller distributable residual profit available for market developing countries than the earlier proposal. We consider that allocation of revenue, as a result of the consensus solution, should be meaningful and sustainable for the market jurisdictions, in particular where they are requested to commit to remove or standstill broader unilateral measures. Otherwise, the solution will be perceived as suboptimal and shall not be sustainable even in the medium term.
5. G-24 wants to draw the attention of the Inclusive Framework that the present work was started to address the tax challenges arising out of digitalisation of the economy and a limited scope of top 100 companies would not address the basic problem. Noting that in the beginning a limited scope would help in reducing administrative and compliance burden for MNEs and tax administrations, G-24 suggests that the scope should be progressively broadened to include

¹ This note was prepared by the G-24 Working Group on Tax Policy and International Tax Cooperation, based on its note in December 2020, and is being submitted on behalf of the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development (G-24). Among G-24 member countries, Argentina, Brazil, Colombia, Cote D'Ivoire, Democratic Republic of the Congo, 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.

² OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*.

more companies. To ensure this, there should be clear visibility of a roadmap for lowering threshold which should be part of the agreement.

6. G-24 understands that for Amount A under Pillar One, thresholds are proposed to ensure that compliance and administrative burdens are proportionate to the intended benefits. However, the process of determination of the thresholds should be inclusive and take into consideration the concerns of small developing economies. For the purpose of nexus, the revenue threshold should be low so that all the jurisdictions that are part of the Inclusive Framework can benefit from the consensus solution.
7. In view of the proposed quantitative scope, it is important that the principle behind revenue sourcing is clear and unambiguous. The overarching principle should be that the revenue is sourced to the final consumer / user.
8. The US proposal 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 remuneration 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 providing goods/ services remotely, 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, G-24 supports return for deemed performance of certain activities like baseline distribution and marketing of digital goods and services for remote sale activities in a jurisdiction. 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 Amount B as such baseline distribution and marketing activities are performed physically, then that jurisdiction would not be entitled to any additional amount.
9. G-24 supports a profit escalator mechanism which was discussed in the Report on Pillar One Blueprint, which could introduce a progressive reallocation percentage with reference to one or more bands of profitability . However, G-24 strongly feels that the reallocation percentage in each band of profitability should be much higher, e.g., it should not be less than 30% and may go up to 50% with higher profit before tax (PBT) margins. This is supported by economic theory as super profits are due to the failure of markets and thus such profit justifies higher reallocation. Similar approach has also been proposed by ATAF in its Revised Pillar One Proposals to the Inclusive Framework dated 12th May 2021³.
10. 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

³ ATAF's Revised Pillar One Proposals to the Inclusive Framework dated 12th May 2021 is available at <https://www.ataftax.org/ataf-sends-revised-pillar-one-proposals-to-the-inclusive-framework>.

countries. The outcome of a focus on dispute prevention will be fewer disputes and less uncertainty. We welcome the efforts of the OECD Secretariat to find alternative to arbitration, since many developing countries are not ready to commit to mandatory and binding dispute resolution mechanisms.

11. So far as Pillar 2 is concerned, G-24 reiterates its supports for the inclusion of Subject to Tax Rule (STTR) as an integral part of Pillar Two so as to address the base erosion concerns of the developing countries. STTR is a simple transaction based rule and hence should be the first one to apply. STTR 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. G-24 favours this rule, in particular, to apply to payments for services and capital gains regarding which many developing countries are experiencing BEPS risks. Further, in line with our aim for simplicity of the rules, G-24 prefers not having a materiality threshold for triggering the STTR as it will limit the application of the rule, while providing an additional layer of complexity and opportunities to create structures to fall out of the rule.
12. Further, G-24 is not convinced of the need for a threshold in Income Inclusion Rules (IIR) as every jurisdiction has the right to tax its domestic companies and this is recognised principle in international tax law. This principle 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.