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Association of German Chambers of Commerce and Industry (DIHK)

DIHK contribution to the public consultation document

Secretariat Proposal for a “Unified Approach” under Pillar One

We would like to thank you for the opportunity to comment on the consultation document referred to above.

A. General Remarks

The OECD Secretariat's proposals are intended to create new distribution mechanisms for the taxation of corporate profits, focusing in particular on highly digitalised business models and so-called consumer-facing businesses. It is intended to open up extended taxation access to the customer/market jurisdictions. It should not matter whether there is a physical presence there, such as a permanent establishment or a subsidiary, or whether corresponding services such as the sale of goods or services are provided remotely from another state to customers there.

The aim of redistributing the tax substrate (Pillar 1) is certainly understandable. Market jurisdictions in particular would like to participate in the profits of companies that provide services to customers/users of the market jurisdiction in question. However, it is critical to question if and in what form customers actually generate added value which should be covered by taxing an enterprise's profit. The current OECD standards on international taxation are explicitly not based on such an approach.

A complete redefinition of the international tax system would be carried out. It must therefore be examined how such a redefinition of the international taxation rules would fit in with the currently implemented system of turnover taxation. Questions would also have to be asked as to whether the – perfectly understandable – fiscal interest of the customer state could not be better represented within the framework of turnover tax/VAT.

The paper of the OECD Secretariat now proposes a so-called "three-tier approach" for enterprise groups that fall within the scope. In addition to the still valid allocation rules (e.g. transfer pricing requirements), further profit shares should be allocated to the market jurisdictions, which can then no longer be taxed by the primal jurisdiction. The following procedure is proposed:

- Initially, a specified ("deemed") share of the total profit should be allocated in advance to the market jurisdictions [Amount A] formula based on sales.
- In addition, marketing and distribution activities should be recorded with higher amounts in the customer jurisdiction than those that result from the transfer pricing requirements according to the arm's length principle [amount B and amount C].

The proposals put forward in the consultation document address considerable concerns on the part of industry. The most important points of criticism and comments from the companies are as follows:

- In view of the scope of the new regulations, it is not possible to draw a precise distinction between consumer-facing businesses and other activities. This applies in particular to goods/services that are directed at both individuals who acquire goods or services for personal purposes and companies (e.g. smartphones).
- The new, extended taxation rights should only apply to very large multinational corporate groups, because only these companies have the necessary financial, material and human resources to implement the new regulations. It is therefore right to remove small and medium-sized enterprises from the scope of application and formulate a sufficiently high threshold. All proposals would lead to far-reaching changes in the international tax system. This would result in a considerable bureaucratic burden, not only on tax administrations, but also on all businesses. In very many enterprises, almost all tax investigation procedures and the entire exchange with the tax authorities would have to be set up again. Small and medium-sized enterprises would be faced with special challenges because these businesses often do not have the necessary resources to implement such extensive rule changes. Exemptions for small and medium-sized enterprises are therefore urgently needed.
- It should also be borne in mind that a "new nexus" would confront companies with considerable registration and reporting obligations in various jurisdictions.
- If market jurisdictions are granted a more extensive right of taxation beyond the existing taxation rights irrespective of the physical presence of a company in the market jurisdiction, the allocation of this "extra share" (Pillar One) should take place outside the existing taxation system. From our point of view, it is necessary to maintain the current profit allocation according to the proven principles (physical place of business, application of the arm's length principle, etc.). The reason for this is that these principles are manageable for companies and tax authorities and have basically proved their worth. Only in a separate step should a correction mechanism be applied (Pillar One) which redistributes according to an "extra share".
- Only by strictly separating the traditional distribution mechanism from the new re-allocation mechanism of the extra share (level 1 – level 2) can it be ensured from our point of view that proven business-related processes in the company – e.g. determination of the transfer prices according to the ALP – are not disturbed ("2-level approach").
- The reallocation mechanism [Amount A] described in the consultation paper would in principle correspond to the "2-level approach" proposed by us.
- However, we reject interventions in the existing transfer pricing system as they are provided for, for example, by amount B and amount C in marketing and distribution activities.

- The most important factor for sufficient acceptance of the rules to be worked out is that clear, simple and practically implementable solutions are found. This applies both to companies that have to implement and comply with the new regulations and to the 134 tax authorities participating in the Inclusive Framework that have to administer the regulations. Moreover, simple and easy-to-use rules, in particular formula-based rules, reduce the number of disputes, ensure legal certainty and avoid double taxation.
- In all the proposals put forward, companies see considerable risks of double taxation. The reason for this is that in many cases, the measures are unlikely to be coordinated in detail in terms of content and timing. All solutions to be developed by the OECD/Inclusive Framework must therefore be consistent and clearly described in themselves so that all states can ensure a uniform interpretation and application. Tax certainty for companies has to be the most important yardstick for reviewing the development of proposed solutions. In particular, the national tax authorities with their very different international structures are likely to make the uniform application of new rules more difficult.
- There are currently no binding dispute settlement procedures for all states. In order to counter the risk of double taxation, the establishment of such dispute settlement procedures is essential. These must ensure that double taxation does not come about as far as possible and – if it does occur – that any double taxation that arises is removed within a short period of no more than one year.
- It would therefore be important that, for the new re-allocation measures, a “single authority” should establish the relevant re-allocation amounts as binding for all participating jurisdictions as a one-stop-shop, so to speak, and monitor their correct use through the national tax authorities.
- With regard to Pillar 1, various states have since introduced so-called “digital services taxes” at the national level or intend to introduce such a tax. Such tax collections must be abolished at the latest when a global set of rules for Pillar 1 comes into force.
- The internationally agreed solutions must be applied simultaneously in all states.
- Ultimately, many companies are very critical of the excessive speed with which work is being carried out on the implementation of these measures. Because changes to the international taxation system have very far-reaching consequences for companies, it would be better to work out co-ordinated proposals without any time pressure. The target set by the OECD/Inclusive Framework for itself of developing a final proposal for a solution by mid-2020 may be understandable from the political point of view. However, the approach carries the risk that technically good solutions cannot be sufficiently worked out and that an agreement will ultimately be arrived at on the basis of a “quid pro quo”.

In the view of the DIHK it is important to state the following: Owing to the short consultation period (October 9, – November 12, 2019) and the considerable complexity of the issues involved, it is not possible to arrive at a final assessment of the proposed options with the initial evaluation presented here. Ultimately, there is also a lack of detailed information on the individual proposals, so that it is not possible to estimate the expected fiscal burden for different companies. The potential impacts on companies and their business models need to be examined in greater detail. In any case, further steps should only be taken by the OECD/Inclusive Framework when much greater knowledge of the impacts of the proposed measures is available. No rash, long-term problematic new regulations should be adopted as a result of short-

term political pressure. In particular, greater consideration should be taken of the bureaucratic burden caused by the new regulations in the future analyses of the situation. Fundamental changes to the international tax system cause a comparatively heavy bureaucratic burden, especially for the small and medium-sized enterprises found in the German SME sector that are affected in many cases in Germany.

B. The measures in detail

1. Scope

Re-allocation in accordance with Pillar 1 should be applied only when companies are covered by the field of application. Conversely, this must necessarily mean that companies outside the scope cannot under any circumstances be the object of a re-allocation.

a) As a matter of principle, a focus on so-called "consumer-facing businesses" is understandable, since the planned re-allocation is intended to take greater account of the importance of the private end-user, i.e. the individuals who acquire or use goods or services for personal purposes, for tax purposes.

However, it is difficult to precisely ring-fence the term "consumer-facing":

- On the one hand, most products and services can be used both by private end-users and in companies (dual use). Therefore, the person of the customer could at best be taken into account if this is a business with the right to deduct input VAT. On the other hand, business models can change within a very short time or new models emerge that are not yet being considered today.
- The Secretariat proposal contains a general description of the activities that fall within the scope ("consumer-facing") – together with certain carve-out rules. However, for reasons of legal clarity and certainty, a positive and exhaustive definition of the relevant activities falling within the scope would be meaningful.
- Due to the large number of delineation problems that arise, clear regulations are required at this point to ensure that companies and tax administrations can be allocated without any doubt and thereby guarantee tax certainty.
- It is also becoming clear that the resulting delineations are extremely conflictual: There is therefore an urgent need for an effective conflict avoidance mechanism and the creation of a competent authority to take a binding decision on the multilateral issues concerned for all companies and all financial administrations involved.

b) With regard to the definition of the group of companies, a uniform OECD definition that is binding on all jurisdictions should be found.

c) In view of the considerable administrative burdens caused by re-allocation under Pillar 1 and the additional registration and tax return obligations, only very large groups of companies should be covered by the field of application. The proposed €750 million revenue threshold is based on the worldwide country-by-country reporting rules and could in principle be a suitable starting point. With a view to the exponentially developing turnover, especially in the digitised sector, it should be determined now how the threshold value will be adjusted in the future.

Against the background that many groups of companies operate different business models at the same time, not all of which fall within the scope of application – which is yet to be defined – the turnover threshold may only cover these activities.

2. New nexus

With Pillar 1, market jurisdictions should be granted an extended right of taxation if the business activities of a group of companies relate to (end-)customers domiciled there. The nexus required for access to taxation can in principle be substantiated by sales.

However, a certain relevance, i.e. a minimum level of sales, is necessary to justify a corresponding nexus, so that the costly re-allocation mechanism is not set in motion by only a few purchases.

This threshold must be set uniformly for all market states and could also be based on the size of the respective sales market. Of course, only those sales which fall within the scope of application should be taken into account.

3. Calculation of group profits for Amount A

The re-allocation of taxation rights according to Amount A is in principle suitable, at least from a systematic point of view, since it does not interfere with the existing taxation mechanisms, but only re-distributes an extra share to the market jurisdictions at another level following the conventional profit allocation. Such re-allocations may not, however, be additionally taxed otherwise by the states.

a) With regard to the determination of the group profit, the consolidated and audited financial reporting in the jurisdiction of the group parent company should be applied in order to have a reliable basis.

b) Further modifications in accordance with other (locally applicable) accounting standards should not be carried out, as these create additional complications and legal uncertainty.

c) However, for systematic reasons, only those business lines that fall within the scope of application can be included.

4. Determination of Amount A

According to the proposal of the OECD Secretariat, Amount A should only be used for excess profits that lie above a previously defined “deemed profit” at Group level. For this purpose, a routine profit should be specified as a binding first step by the states / Inclusive Framework. The excess amount, i.e. the above-normal profit, should then be used – in part – for the purposes of re-allocation, whereby this share is also specified in a binding manner by the states. The amount available for distribution (Amount A) should then be distributed to the market jurisdictions concerned formula based on sales, for example. A “10 over 10” approach is already under discussion.

From the point of view of companies, such a formal definition of these parameters that is not based on individual cases is necessary as a matter of principle in order to ensure legal certainty and legal clarity for companies.

However, the defined deemed profit should be sufficiently high to prevent Amount A from re-allocating supposedly "excessive" profits that do not actually exist.

Amount A, which is subsequently to be calculated by means of a fixed proportion and released for re-allocation, should be set sufficiently low, since not only the envisaged market and customer-related factors, but also other factors such as R&D, synergy effects or the technological processes used contribute to increasing profits.

The distribution of the formulaically calculated Amount A among the market jurisdictions should take place in accordance with the turnover available there. For the exact assignment, however, simple and easily manageable parameters must be found that take into account both the type of service and customer participation (goods or digital services, paid or unpaid) and the form of distribution. The discussion should not only focus on technically feasible procedures, but also on procedures which are proportionate.

With regard to the various distribution structures, it remains to be said that sales to third-party distributors/intermediaries must not be allowed to fall within the re-allocation mechanism, as corresponding end-customer turnover is taxed by them in the sales market and, if necessary, re-allocated.

Negative Group results and losses should not be artificially broken down into a negative deemed profit and a positive non-deemed profit which is then partly re-allocated as Amount A.

5. Elimination of double taxation in relation to Amount A.

With the re-allocation of a fixed profit share to a market jurisdiction [Amount A], the original allocation of the Group profit to the participating states is changed and a part of the Group profit is now allocated to the market jurisdiction. In order to avoid any double taxation of this amount, corresponding compensatory measures would have to be implemented.

From the systematic logic it would be consistent to reduce Amount A as a re-allocated part of the Group profit from the tax base of another Group member so that no more than the 100%-Group profit (distributed worldwide) is taxed. If one assumes that profits and losses of a Group regularly end up at the parent over time, the corresponding deduction amount could be taken into account there. In view of the various Group strategies, a right to choose could also be established.

Whether and to what extent other corrective measures are also suitable has to be discussed in each individual case. It would be conceivable, for example, that the additional tax payment by Amount A in the market jurisdiction would trigger a tax reimbursement/credit claim of the same amount at the Group parent or a Group member vis-à-vis its fiscal authority.

6. Amount B

In our opinion, Amount A can ensure sufficient participation of the market jurisdictions in the Group profit. There is therefore no need to implement a further corrective mechanism (Amount B, Amount C). In addition, a further corrective mechanism under Amount B would directly interfere in the regular corporate taxation [here: Level 1], instead of implementing a correction outside the system [here: Level 2].

The distinction made in the Secretariat proposal between "baseline" and "beyond baseline" activities also triggers considerable difficulties in distinguishing between them. Therefore, a clear and legally secure definition should be made which prevents different/conflicting interpretations by the participating states.

It is clear that disputes between countries in this regard will be fought always at the expense of companies. The designation of a "competent authority" is therefore urgently required to take the relevant decisions with binding effect for all the tax authorities involved.

7. Amount C / dispute prevention and resolution

In view of the large number of jurisdictions involved in a re-allocation mechanism, the uniform and binding application of the regulations is mandatory. First, it is necessary to establish simple, clear and easy-to-use definitions, including definitions of terms. It also makes sense that the entire re-allocation according to Pillar 1 should take place in a uniform, centralised tax audit process and not be atomised into a multitude of national taxation procedures.

In addition, a mandatory binding arbitration mechanism is required, which must be completed within a short period of time – ideally within one year. The procedures laid down in some double taxation agreements can be continued, although these procedures need to be significantly improved and shortened.

With regard to the APAs referred to in the consultation document, it should be noted that it is difficult to determine and establish in advance (ex-ante) re-allocations of actual profits achieved in a given year, because frequently changing business models make it difficult to make a reliable forecast.

Therefore, the DIHK advocates the creation of a "competent authority" to regulate the application of Pillar 1 in a binding manner for all participating states. This "competent authority" should also be the only point of contact for the respective company in all disputes (one-stop-shop).

C. Contact persons with contact data

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D. DIHK – Who we are

The Association of German Chambers of Commerce and Industry (Deutscher Industrie- und Handelskammertag, DIHK e.v.) is the central organisation for 79 Chambers of Commerce and Industry, CCI (Industrie- und Handelskammern, IHKs) in Germany. All German companies registered in Germany, with the exception of handicraft businesses, the free professions and farms, are required by law to join a chamber.

The DIHK speaks for more than three million entrepreneurs. They include not only big companies but also small and medium-sized enterprises. It does not represent any specific corporate group but all commercial enterprises in Germany. Thus, the DIHK opinions are equilibrated and well-balanced taking into account the whole business' requirements.

The DIHK also coordinates the network of the 130 German Chambers of Commerce abroad as well as delegations and representative offices of the German economy in 92 countries.

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