Tax Policy and Statistics Division
OECD Centre for Tax Policy and Administration
2, rue André Pascal
75775 Paris
France

14 December 2020

Submitted by email: cfa@oecd.org

Joint comments by:

- **The Confederation of Swedish Enterprise**
- **The Confederation of Finnish Industries**
- **The Confederation of Danish Industry and**
- **The Confederation of Norwegian Enterprise**

on the OECD Public Discussion Drafts: Tax Challenges Arising from Digitalisation – Reports on Pillar One and Two Blueprints 12 October - 14 December 2020

The Confederation of Swedish Enterprise is Sweden's largest business federation representing 49 member organizations and 60 000 member companies in Sweden, equivalent to more than 90 per cent of the private sector.

The Confederation of Finnish Industries EK is the leading business organization in Finland. EK represents the entire private sector, namely 24 member associations and 15,300 member companies across all business sectors. The member companies employ 900,000 employees.

The Confederation of Danish Industry (DI) representing more than 18,000 companies is Denmark's largest, most representative and most influential business and employers' organisation, covering manufacturing as well as service industries across sectors such as transport, energy, IT, health, trade and professional services.

The Confederation of Norwegian Enterprise (NHO) is Norway´s largest organisation for employers and the leading business lobbyist with a current membership of more than 28 800 companies.

Our Confederations are pleased to provide joint comments on the OECD Discussion Drafts Tax Challenges Arising from Digitalisation – Reports on Pillar One and Two Blueprints 12 October - 14 December 2020 (hereinafter referred to as Pillar 1 and 2).

General Comments

Our Confederations consider it to be of utmost importance to find a global solution to the challenges from the digitalization of the economy. The OECD, which has an instrumental role to play in this process, has so far made significant progress. We recognize the political pressure at hand and the additional challenges presented by the Covid-19 pandemic. What is needed is a consensus-based sustainable international tax system which is predictable, usable, enforceable and that also facilitates and supports future growth.

When designing a new tax system, it is important to strike a balance between complexity and compliance issues and the policy objective at hand. In order to minimize the risk of divergent interpretation and double taxation, it is also important that the new rules are principle-based, However, our Confederations are concerned about the fact that what is outlined in the Blueprints is neither simple nor principle-based.

The new rules also need to be compliant with EU- and EEA[1]-law. If not, they will not be sustainable and may consequently need to be renegotiated. Main areas of concern seem to be the rules under Pillar 2, and in particular the income inclusion rule, since it targets not wholly artificial arrangements. Consequently, this is an area which needs to be analysed further.

We note that political agreement is lacking in relation to many key issues such as scope, nexus, quantum, rate, rule-coordination etc. We urge the members of the Inclusive Framework to work closely together in order to reach a consensus-based agreement. Without greater clarity and agreed principles and definitions among all countries in the Inclusive Framework we believe that it will be virtually impossible for businesses to get any kind of legal certainty at an early stage.

As to the implications on legal certainty and administrative burden, our Confederations are of the opinion that the proposed "Amount B" procedure under Pillar 1 is unlikely to lead to a significant reduction in transfer pricing disputes or to a

[1] European Economic Area

material improvement in legal certainty. This is due to the fact that determining the applicability of the Amount B approach requires in itself most of the steps of a full-blown transfer pricing analysis. Thus, determining the scope of "baseline marketing and distribution activities" subject to the Amount B approach is likely to generate a substantial number of new disputes. We stress the necessity to define the scope of Amount B as unequivocally as possible. We suggest that a phased-in introduction would be considered in order to gather experience on whether the Amount B actually works as intended.

From small countries perspective, we are concerned about the shift of taxable income under Pillar 1 from smaller net exporting countries with high levels of R&D-activities and associated entrepreneurial risk taking to larger net importing jurisdictions with large consumer bases. This may well disincentivise countries from developing a good and competitive investment climate to support innovation and entrepreneurship. The rationale for a country to spend public funds on advanced educations, technological developments and entrepreneurship would arguably decrease if the taxable proceeds from these activities are redistributed to where the consumption takes place. Conversely, the incentive for markets with large customer bases to ensure efficient and competitive investment climates would arguably be reduced if the proceeds will be taxed there regardless.

A report[2] earlier this year from European Center for International Political Economy (ECIPE) assessed the potential impact the OECD proposals would have on small open economies. The report highlights that the OECD proposal to shift effective taxing powers away from small open economies to the world’s largest countries would undermine small countries’ relative attractiveness to international businesses and would induce domestic businesses to relocate to larger countries with the gravity of larger markets.

The tax bases of export driven economies may be substantially reduced if companies relocate production activities to market jurisdictions in which a larger proportion of profits will be taxable than today anyway. Costs will then match incomes at the same tax rate in the market jurisdiction. The relocation will decrease the demand for labour and other production factors in the exporting country, which in turn reduces the income tax base, and with lower income, also the consumption tax base. These tax bases are considerably larger than the corporate tax base and could have a large negative impact on tax revenues.

For small research-intensive open economies, the report finds that the OECD proposals would undermine future investments in R&D, innovation and business expansion, with adverse implications for existing research clusters, education systems and high value-added jobs.

[2] Unintended and Undesired Consequences: The Impact of OECD Pillar I and II Proposals on Small Open Economies by Matthias Bauer, ECIPE, Occasional Paper 04/2020.

In relation to this, more clarity is requested concerning the treatment of losses. Many venture capital investments never generate any corporate tax revenue and very few become global players. With a residual profit split approach, the costs for innovation and development for all the failed venture capital investments would likely remain in the exporting country, while future profits for the few successes would, at least partly, be taxed in other countries, without proper recognition of the costs or pre-regime losses. It seems a fair question to ask why the country funding the R&D should not be allowed to symmetrically tax profits if and when they materialize. From a country perspective, in order to cover the average development cost, any successful investment would effectively have to cover the costs of all the previously failed investments. It is therefore important to provide enough profits in the innovator jurisdiction to reward R&D and incentivize discovery and to allow for losses, both pre-regime and in-regime, to be carried forward on an unlimited basis.

Our Confederations are positive to the introduction of an early certainty process and encourage a strong focus going forward on simplification and dispute prevention measures in order to reduce future disputes. Mandatory binding arbitration is another necessary component, to facilitate that mutual agreement procedures function in a timely matter.

The introduction of unilateral measures in many jurisdictions has fuelled the debate on the necessity of reaching international consensus. Should the Inclusive Framework reach an agreement on Pillars 1 and 2, such an agreement must also require the removal of any current unilateral measures in force and a political commitment by the members not to introduce such measures in the future.

We recommend that a common global reporting solution, “one stop shop” is developed by the OECD for the purposes of Pillar 1 tax reporting and filing as well as the collection of the tax revenue. In any other scenario, the cost of reporting Amount A may well exceed the tax proceeds to be reallocated to the jurisdiction in question as Amount A.

Pillar 1

Scope and Nexus

Defining the scope of Amount A is a key issue for the whole project. In order to reduce administrative burden, provide legal certainty and prevent disputes, businesses need to have a sufficiently clear understanding of which activities fall within the scope. Ambiguity concerning the scope might also have a negative impact on the possibilities of achieving early certainty through the review panel process.

The use of positive and negative lists as a supplement to the general definition of automated digital services (ADS) is helpful. However, due to the ever-changing economy, it will be a challenge to keep these lists updated, especially since this

needs to be done under a consensus-based procedure, as opposed to unilateral changes by various jurisdictions. Further clarity is requested on how this can be achieved.

Although considerable progress has been made since the unified approach was presented last year, the concept of consumer facing business (CFB) is still very unclear. A company may create a nexus by participating in an active and sustained manner in the economic life of a market jurisdiction. However, there is still not enough detail as to what participation in an active and sustained manner really means. More clarity on this aspect is required.

We are also concerned that the distinction between ADS and CFB, e.g. by requiring plus factors for CFB but not for ADS may, despite the intention not to do so, result in ring-fencing the digital economy. We believe that the plus factors represent a good way to demonstrate a sustained engagement in a jurisdiction and that they should apply to both CFB and ADS. However, irrespective of a plus factor test, a company should, based on facts and circumstances, be able to rebut the presumption that it has an active and sustained participation in a jurisdiction.

While we agree that an overall phased approach may help tax authorities and taxpayers as part of a learning process, we believe that it would be preferable to have a system that is well developed from the outset, so that double taxation cases can be avoided. We would therefore encourage members of the Inclusive Framework to develop a comprehensive multilateral convention containing clear and effective rules in terms of scope, enforcement and timeliness, for dispute prevention and resolution concerning the application of both Pillar 1 and 2.

As far as the de minimis foreign in-scope revenue threshold is concerned, careful consideration needs to be taken in order not to disadvantage companies headquartered in small countries in vis-à-vis companies headquartered in jurisdictions with larger markets. However, in order to avoid on-off sales creating a nexus in a jurisdiction where a company´s overall engagement is insignificant, we believe that such a threshold should be exceeded over a longer period than one year to create a nexus, e.g. over a three-year period.

Revenue Sourcing Rules

The revenue sourcing rules with its hierarchy of indicators are by many viewed as one of the most complex parts of Pillar 1. In order to provide greater simplicity in application of these rules, we believe that the starting point for revenue sourcing should be based on information already available or easily retrievable for businesses. The existing VAT rules on Electronically Supplied Services are familiar to many taxpayers and could therefore provide insight into this area.

Sourcing rules based on the location of end consumers/users propose significant concern for many businesses, in particularly those that sell products through intermediaries, e.g. consumer product companies or cloud service providers. These cases are often multi-layered, involving multiple transactions before reaching the end consumer. In many situations the taxpayer does not have access to information regarding sales made by a third-party distributor to an end consumer in a particular jurisdiction.

Our Confederations encourage the OECD's to look at further simplification measures for the revenue sourcing rules in order to limit the requirement to collect consumer sales data to what is manageable to business, i.e. information that business already have, or with reasonable ease can access.

We are concerned that revenue sourcing rules may not be compliant with the European GDPR rules. GDPR and privacy protection does not allow tracking of the real time geographical location of users and collecting and storing such data. The reliability of third-party data may also be questionable.

Loss Carry-Forward Rules

Our Confederations welcome the efforts in the Blueprints to develop a system on loss carry-forward rules. The unwillingness of countries to accept losses from other jurisdictions constitute a significant challenge. It is important to address the need for, and the methods of, how to allocate costs and losses among countries, so that the net profit of the Group is taxed over time. Many start-ups and R&D intensive companies generate losses when establishing their businesses.

Over the last decade we have also experienced a significant financial crisis as well as the Covid-19 pandemic, both resulted in considerable losses for many companies. In order to account for these events as well as losses for businesses with long-term economic cycles, we believe that the system should allow for losses, both pre-regime and in-regime, to be carried forward on an unlimited basis.

The Issue of Double Counting

The objective of Amount A is to allocate a taxing right to a market jurisdiction where residual profits have not been allocated under existing tax rules. Consequently, If Amount A rules are designed correctly, there should, at least in theory, be no risk of double counting.

However, many members are concerned that double counting will become a problem and that Amount A will be charged by market jurisdictions on top of existing tax liabilities on local activities or withholding taxes levied.

It is crucial to provide a clear set of rules to prevent ambiguity and risk of double counting. The marketing and distribution profits safe harbour with the “cap-mechanism”, limiting the allocation of Amount A to market jurisdictions that already have taxing rights over a group’s profits, could be helpful.

Elimination of Double Taxation and Tax Certainty

Our Confederations welcome the OECD initiative to create an early certainty process to prevent disputes and the commitment to mandatory binding arbitration. The proposals as presented in the Blueprints, involve new concepts of taxing rights and the allocation of profits are likely to result in divergent interpretation and an increasing number of disputes. Some of these disputes could involve many countries simultaneously, something which the current dispute mechanisms are not equipped to deal with.
Unfortunately, this comes at a time when the number of cross-border tax disputes already are increasing. With reference to the latest OECD statistics[3], we note that the number of times that taxpayers needed to resort to the mutual agreement procedure (MAP) in order to resolve a transfer pricing dispute increased by more than 20 per cent between 2018-2019 and nearly doubled since 2016. It is also stated that this trend is likely to continue. As we move towards a new tax framework this negative trend must be dealt with as it could have a large impact on cross-border trade and investment. A robust system of dispute prevention and avoidance is of utmost importance.

Many MNEs will no doubt have high expectations on the early certainty process. There is, however, concern that tax administrations will be flooded with companies seeking early certainty and due to resource constraints will have difficulty in delivering timely certainty to meet the demands.

From what we understand, the review panel would be dealing with all aspect of Amount A. Consequently, there are a number of issues that will have to be clarified in advance of a final agreement between the members of the Inclusive Framework. This includes the composition of the panel, financing, timeline to solve disputes etc. The review and determination panels should, in our view, not consist of the same individuals as members, so as to ensure neutral treatment of taxpayers. In addition, we believe it would be valuable to have persons from various backgrounds involved in the panel process, in order to ensure a full understanding of the digitalised business models and the technical side of the business. It must also be stressed that the information provided under the review and determination panel processes is kept confidential and only used for Pillar 1 purposes.

---

[3] https://www.oecd.org/tax/oecd-releases-2019-map-statistics-and-calls-for-stakeholder-input-on-the-beps-action-14-review-on-tax-certainty-day.htm

As far as the method used to eliminate double taxation from Amount A, we would prefer the use of the tax exemption method. The credit method would entail more complexity and may, due to various limitations, not lead to full tax credit being achieved, thereby resulting in double taxation.

Segmentation

Segmentation should be voluntary in all cases and it should not in any case lead to situations where Amount A becomes payable where the whole MNE is not profitable.

Amount B

General comments

Introduction of Amount B may just shift the core of the transfer pricing disputes to the definition of baseline activities. It is questionable whether Amount B would lead to fewer transfer pricing disputes as introduction of Amount B would merely remove one step from arm's length pricing process, namely benchmarking.

In our view, benchmarking is not the most time-consuming part of the process and not the step where most disputes are rising from. In contrast, our members are concerned that determining the fixed Amount B levels would prohibit MNEs from determining the compensation level from an arm's length perspective. The fixed remuneration range should be wide enough for MNEs to pick the most suitable and adequately arms' length level of compensation in each case and structure and include enough flexibility in all cases and consider, e.g., differences in markets. Amount B should not lead to situations where low-profit or non-profitable activities are heavily taxed or to situations where the Amount B does not correspond to the actual business model used by the MNE.

Specific Comments

IX. The issue of scope of Amount B and definition of baseline marketing and distribution activities. More specifically, comments are invited on the following points:

a. Do you consider that Amount B should be narrow in its scope or should it take on a broader scope? What are the advantages or disadvantages of a narrow or broader scope? [Refers to paragraph 659 of the Blueprint]

The key aim of Amount B is to improve certainty and decrease the current disputes landscape. Considering this, in terms of the question if the scope of Amount B should be narrow or broader, the first impression would be that of a broader scope. However, this approach includes many problems. The looming debates and antagonistic positions concerning the inclusion or not of a certain activity under the regime would not be significantly reduced but shifted to other activities on the borderline of Amount B and non-Amount B activities. In all cases, the regime can be used discretionary (e.g. the local jurisdiction would not include a certain entity in the scope of the Amount B but it will use the defined benchmarks/profitability to argue for a higher remuneration). This situation can very well be the case, as it is common that the entities in the current cross-border environment lack a 100% straight forward profile.

In order to be aligned with the TPG and the term "accurately delineated transaction" the range of fixed return needs to be broad enough allowing a wide selection of comparability sets that recognize differences in functional intensity. Otherwise Amount B would not be in line with the TPG and the arm's length principle. Analogously, if Amount B return range does not leave room for any adjustments for functional intensity or risk profiles, the scope needs to be narrowed for Amount B to be in line with the TPG and to reflect an arm's length remuneration. The correct identification of the transaction, and all circumstances surrounding it, is core to all TP analyses and was the guiding star of BEPS and the backbone of the new TPG. A broad scope with less/no room for taking different functional intensity and business models into account would be a violation of BEPS/TPG.

Regardless of a narrow scope or a broader scope that opens up for different comparability sets and adjustments for functional intensity and risk profiles, we see a huge risk of an increased number of disputes on (i) either if an entity is in or out of scope of Amount B all together, or (ii) how the functional/risk profile should affect the comparable set and Amount B which will lead to increased uncertainty, administrative cost and risk for double taxation for multinational companies.

b. Do you consider the baseline activities outlined in the positive and negative list achieve the narrow scope definition examined in the Blueprint? If not, what changes should be considered? What changes to these lists would be required if a broader scope was adopted? [Refers to paragraphs 664-673 of the Blueprint]

The list is too broad if the benchmarks do not include different comparable sets and a range wide enough to recognize differences in functional intensity (see comments under a.). Considering that the purpose of the Blueprint and Amount B seems to be to avoid such adjustments, the alternative would be to significantly narrow the scope.

However, we cannot see how the list can be narrowed enough in a way to avoid different interpretations by authorities and taxpayers on whether an entity is in or out of scope (with resulting audits and double taxation situations). On the other hand, we see a correspondingly obvious risk for disputes with a broader scope (see comments under a).

Our view is that it will be very challenging to implement an Amount B that will both meet the objective to reduce disputes and improve the certainty for tax payers while also be in line with the TPG and arm's length principle and provide a "fair" allocation of taxable profit between countries in which an MNE is operating.

In addition, the services dimension is not sufficiently touched upon. Namely, an entity can be a distributor of services not just products, or alternatively it can be a distributor of technical services related to the products that it is selling (distributing) to the end customers. In the current world, it is counter-intuitive to imagine many businesses that are just sellers of products but not also of related services. Thus, it should be further clarified the idea of services distribution and not to exclude such reality by default.

d. Do you consider that multifunctional entities (i.e. entities that perform baseline marketing and distribution and other activities) should be eligible for Amount B? [Refers to paragraph 680-684 of the Blueprint]

As transfer pricing is based on transactional analysis our view is that also multifunctional entities must be eligible for Amount B, although obviously only for their distribution activities. MNEs should already today have segmented P&Ls and be able to segment out the in-scope activities so in this respect we do not see a difference.

e. Do you consider that Amount B will be effective in reducing disputes? If not, why? [Refers to paragraph 664-673 of the Blueprint]

No. Whereas disputes on what percentage to apply for calculating the remuneration presumably will decrease (assuming that the range of comparables is not very wide), we see a huge risk that there will be disputes on whether functions/entities are in or out of scope. Further, we are concerned about how this issue can be solved without violating the arm's length principle as it stands after the BEPS amendments as interpreted in the TPG.

X. The appropriate profit level indicator for calculating Amount B, and how it should be calculated assuming Amount B is based on a narrow scope. More specifically, comments are invited on the following points:

a. What the appropriate profit level indicator should be, for example whether a return on sales set at the (potentially adjusted) EBIT or PBT level should be used? [Refers to paragraphs 686-688 of the Blueprint]

Only accepting ROS as PLI is in general too narrow. TPG mentions four PLIs (including berry ratio) as possible methods to apply the TNMM. Only accepting ROS would ignore all other OECD accepted PLIs/methods and thereby not taking different business model into account.

If ROS nevertheless is agreed upon and decided as the sole PLI to use, it should be on EBIT level and the sale should be adjusted for product returns, refunds, rebates and FX implications as these are ordinary items in the operations (in contrast to interest that are rather related to the financing of the operations).

b. Do you consider that Amount B should account for variation in returns to baseline marketing and distribution activities by industry and/or region? If yes, what industry and/or regional variations should be considered? Are there any other differentiation factors that should be considered? [Refers to paragraphs 690-693 of the Blueprint]

Profitability and margins vary substantially between industries and regions which is explained by the five economic factors mentioned in TPG.

The most obvious regions given economic conditions and realities and the availability of reliable comparable companies (and current TP regulations) could be Asia-Pacific; EMEA (with a possible split between Europe and Middle East & Africa) and the Americas (with a possible split between North America and Central & Latin America). Even if there is a split based on regions the end outcome of the exercise should normally be generally aligned. An industry split can potentially also exist even if in theory, given the functional profile of the entities and the profit level indicator to be used, normally again the variations should be limited.

Pillar 2

General Comments

Our Confederations question the rush for addressing what is believed to be outstanding BEPS issues. A global minimum tax was not part of the initial BEPS project and the stated objective is not convincing. Many of the BEPS actions have just recently been implemented and the effectiveness of these implementations are yet to be evaluated. In addition, the impact assessment is based on data prior to the implementation of the BEPS actions. Consequently, it is not clear to what extent any outstanding BEPS issues remain.

A fundamental principle in the BEPS project has been to ensure taxation where value is created. The GloBE proposal deviates from this principle since profits that has been generated in a subsidiary will be taxed in the hands of the parent company (the shareholder), irrespective of whether there is relevant substance in the subsidiary or not.

The introduction of a global minimum tax constitutes a serious blow to tax sovereignty, since it undermines the possibility of a country to design its tax system in accordance with its economic policies and priorities. Measures that undermine the sovereign right of countries to maintain or introduce new appropriate fiscal incentives to stimulate innovation, investments and growth should not be introduced.

Our Confederations favour fair transparent tax competition. Such competition increases pressure on governments to implement efficient and competitive tax legislation which in turn facilitates investments, growth and new jobs. An overall increase in the corporate income tax burden on the other hand, will have a negative impact in the areas mentioned.

Many countries, including ours, already have measure in place, e.g. CFC rules, addressing low tax situations. The introduction of another set of parallel rules would add yet another layer of complexity and administrability to the overall system. Countries with regimes providing sufficient protection against low ETRs should be shielded from application of the additional layer of complex rules in Pillar 2. Alternatively, the national regime must be repealed. One option would be to treat the current ATAD CFC rules as a compliant Income Inclusion Rule, similarly to the proposal on GILTI co-existence.

Our Confederations question whether the GloBE, as presented in the Blueprints, is compatible with EU- and EEA-law. The Income Inclusion Rule resembles CFC regimes. Such regimes should only target artificial arrangements, not apply to genuine commercial activities. A top-up tax in accordance with the Income Inclusion Rule could, in our view, be triggered exclusively by low effective taxation, lacking concrete criteria relating to practices of abuse. If that is the case, it would mean that the measure goes beyond the objective to address genuine BEPS concerns and cannot be justified, resulting in a disproportionate restriction on the freedom of establishment. [4] We believe that a thorough analysis on this issue is necessary.

In addition, the formulaic substance-based carve out fails to recognise the role of intangibles in business models. Therefore, a measure of the contribution of intangible investments should form part of the calculation.

As is the case with Pillar 1, the Pillar 2 proposal is also extremely complex and is likely to result in a number of new disputes. Consequently, it is of utmost importance

[4] We share the views expressed by Professor Luc De Broe in OECD’s Global Anti-Base Erosion Proposal (“GloBE”) – Pillar Two Raises Fundamental
Concerns of Compatibility with EU Law (KU Leuven), 3 December 2019.

that an agreement on the introduction of a minimum tax should come with necessary dispute prevention measures as well as a commitment from members of the Inclusive Framework to agree to mandatory binding arbitration.

Blending

Our Confederations favour the global blending approach, where the determination of whether an income is low taxed is based on an aggregate consolidate basis. Although we understand that a global blending approach is not optimal from a revenue perspective, we believe there are at least three very good reasons for choosing the global blending approach over the jurisdictional approach.

Firstly, the global blending approach would entail significantly less administrative burden and complexity compared to the jurisdictional approach.

Secondly, the global blending approach is less intrusive from a tax sovereignty perspective than the jurisdictional approach.

Finally, a global blending approach may also make the rules more in line with EU law. With this approach, a minimum tax would only be levied in a situation where the total tax on all the foreign profit of an MNE, as opposed to a tax in a particular jurisdiction, would be below the minimum tax rate.

Simplification Options

Considering the complexity of Pillar 2, there is an urgent need for simplification. The complexities and administrative burden are hard to evaluate in terms of the barriers to conduct business and the limitations to investment.

In order to introduce Pillar 2 in the least administrative burdensome manner, multiple simplification measures will need to be implemented simultaneously. While some of the options described in the Blueprints may be more effective than others, MNEs differ significantly. It is therefore important to further analyse and refine all the proposed measures, and possible others, so that they can be introduced as a package.

Tax Administrative Guidance

From a compliance perspective, we believe the tax administration guidance would be the simplest and most straight forward proposal for businesses to comply with.

If implemented broadly this could generate a default identification of the jurisdictions, a “white list”, where the tax base does not materially depart from the GloBE tax base

and the tax rate is sufficiently high, thus allowing a presumption that an MNE's ETR in that jurisdiction exceeded the agreed minimum rate. Such work should be done before the actual start to roll-out for implementation of any final proposal.

Single Jurisdictional ETR Calculation to Cover Several Years

This proposal could be useful although provided that the period is sufficiently long. It would clearly indicate that once the MNE has a certain ETR in a reference year it is not considered by default non-compliant but the other way around with the potential “burden of proof” being balanced between the taxpayer and authorities.

De Minimis Profit Exclusion

The De minimis profit exclusion could also be a useful simplification. It should be based on a certain percentage of an MNEs Group pre-tax profit supplemented by a reasonable high fixed minimum amount. It is important to study this simplification together with the CbC-report safe harbour, as MNEs would still be required to calculate the pre-tax profit for every jurisdiction. A de Minimis Profit exclusion without the CbC-Report as safe harbour would render only very limited simplification advantages.

Country-by-Country (CbC) Reporting ETR Safe-Harbour

Even if such simplification would be welcomed at least two points should be mentioned. The first is that adjustments and calculations for each jurisdiction would still need to be done so the complexity may still be there but under a distinct form. Second, care should be applied in terms of the further “enriched elements” that the CbC reporting is given because certain jurisdictions still demand some other formats of the document, use it for more than just high-level analysis of TP and in essence, have a tool for discretionary and un-coordinated approaches. In case the CbC receives further weight, this could further exacerbate its usage for unilateral purposes not intended in the guidance. CbC is and should remain a high-level risk assessment tool.

Further analysis on this option is needed with a view to keep the required adjustment to use CbCR at a minimum.

Impact Assessment

The Impact assessment comprises many considerations. It is an impressive document which we are happy to provide comments on despite it is not explicitly part of the consultation. Despite its comprehensiveness, certain elements are left

out or underestimated. Our comments focus on the limitations rather than praising the considerable merits in the calculations in the Impact assessment.

The basic conclusions rely heavily on a number of critical assumptions and ad hoc adjustments to empirical data. The main effect on the wellbeing of workers depends on the effect on investments and the creation of job opportunities. The assumed investment response is therefore a key parameter.

Effect on Investment

The study estimates the impact on investments through investment costs, using basically a King&Fullerton, Devereux&Griffith approach of forward-looking effective tax rates (ETRs), here calculated at the MNE level. Further assumptions are that the firm is a large MNE in a profit position and that investment is financed by only retained earnings; the treatment of loss-making firms is, therefore not considered. The investment is constructed as an unweighted average across three broad asset categories, non-residential structures, tangibles assets and acquired intangibles.

It should be recognized that the results in these models are driven by the dispersion of tax parameters and the relative distribution of distortions. There are often no or very weak links to the investor level and his/hers decision to work, save and invest overall. A certain investment bundle (see above) is assumed to be invested and the effect of taxes is the distribution across jurisdictions rather than on the decision to invest at all. An outcome with lower dispersion of rates is seen as enhancing effectiveness.

However, clearly not all investments will be undertaken if the tax rate yield a low after-tax rate of return at the investor level. Therefore, the absolute level of taxation must also be considered, and not only the relative distribution of effective tax rates.

The calculations are done assuming a large profitable MNE and not the rate of return to the investor after dividends are paid and capital gains realized so that the investment decision is put to a market test and a possible consumption/investment decision or reallocating to other investment opportunities, like in a purely domestic sector (like real estate). The underlying ultimate parent entity is in this respect not representative for how investment decisions are taken.

Pre-BEPS Data

When assessing the relative distribution of tax rates, it should be noted that the underlying data pre-date important recent developments, most notably the 2017 US tax reform, implementation of some aspects of the OECD/G20 Base Erosion and Profit Shifting (BEPS) package and the COVID-19 crisis. This will also make the calculations based on the relative distribution of effective tax rates uncertain.

The tax sensitivity of investment is based on the industry-level estimates developed by Sorbe and Johansson (2017)[5], as their empirical approach is aligned (ad hoc) with the estimates discussed in Section 4.6.

Pillar 1 and 2 are assumed to lead to a relatively small increase in the average (post-tax) investment costs of MNEs. The ensuing negative effect on global investment is estimated to be very small, as the proposals would mostly affect highly profitable MNEs whose investment is less sensitive to taxes. The impact of the proposals is expected to fall predominantly on highly profitable MNEs in digitalised and intangible-intensive sectors in the case of Pillar One.

A reason for the assumed low elasticity is that the highly profitable MNEs are assumed to engage in tax planning and profit shifting behavior to a greater extent than other MNEs.

To base the calculations on a tax planning assumption is surprising. The very purpose of BEPS, and now Pillar 2, is to eliminate or substantially reduce artificial profit shifting due to differences in the level of effective taxation. By using pre-BEPS data and by assuming extensive profit-shifting, the rationale for the measures taken or underway is questioned in an unfortunate way.
Even if the impact on highly profitable MNEs were to be limited, the effect on the development of the most productive sector in the economy – highly digitalized businesses – could reduce the achievement not only of the European digital agenda, but overall digitalization and productivity gains in the world economy. This effect could be very important and should be considered as counterfactual.

The investment elasticity should in any case reflect not only existing MNEs with high profits in some years, but also the response of innovators and entrepreneurs to the new tax environment. The effect on investments is therefore likely to be much larger than the one assumed in the OECD analysis.

The investment elasticity will also depend on the impact the tax changes will have on government behaviour and on decisions for incentives. The study is limited in this respect, only mentioning possible effects on tax revenues from changed tax competition behaviour.

Implications for Government Behaviour

If Pillar 1 and 2 are implemented, government behaviour is however likely to be profoundly affected.

---

[5] Johansson, Å. et al. (2017), “Tax planning by multinational firms: Firm-level evidence from a cross-country database”, OECD Economics Department Working Papers, No. 1355, OECD Publishing, Paris, http://dx.doi.org/10.1787/9ea89b4d-en.

We know that most new businesses will fail and very few will become highly profitable. Governments typically try to create a sound environment for innovation and entrepreneurship by recognizing start-up costs and allowing for loss-offset provisions in the tax code, and R&D incentives are common. Through the right to tax highly profitable businesses, deductions can be afforded creating a positive business climate.

If a country has to share the tax revenues with other countries on the few highly profitable successful businesses but will remain with the losses and start-up costs, the business climate may take a turn for the worse. The reduced revenues from the profitable companies may have to be recouped from other businesses, if social objectives are to be met.

The investment response from such changed government behaviour is not recognized in the analysis but it may over time be very important for jobs and tax revenues.

Implications for Corporate Behaviour – Tax Certainty

There is also likely to be effects from the two pillars on the business models and the structure of MNEs and their business lines. It is well-known that certain business lines have a very low profit margin. By combining high profitable business lines with low profitable lines, the overall level of profitability may be affected in such a way that allocation rules according to Pillar 1 may become irrelevant. Such a behaviour is of course costly in economic efficiency terms and the magnitude of such behaviour ought to be included in the overall cost assessment of the reforms.

Smaller countries, with a limited consumer market, may suffer considerable tax revenue losses. They may have limited market power to exert pressure on the tax outcome when disputes arise between tax authorities. By allocating taxation powers to large market jurisdictions, MNEs will be incentivized to locate headquarters and functions in large economies since their tax authorities are likely to have bigger bargaining powers than tax authorities from smaller countries. The tax system will add to increased gravity to the centre and peripheral countries may increasingly be disadvantaged. Such effects are not included in the impact assessment.

The complexity of the proposals and vague definitions will lead to uncertainty and reduced investments. The administrative costs for businesses will be large. There is a clear risk that border lines between consumer facing businesses and other businesses will generate innovative “solutions” in the board rooms. After all, aren’t all businesses there to satisfy the needs and requirements of consumers? The distortions and costs of how to measure effective tax rates on a transactional basis are huge. The costs for societies before vague concepts are clearly defined are also huge and it will take many years before certainty is high enough to eliminate a

negative impact on investment behaviour. However, that is a cost of change which may be justified but it ought to be included in the impact assessment.

Tax Competition

Regarding the impact on tax competition, it is recognized in the Impact assessment that under certain conditions the new tax rules proposed could serve to limit the ability of government to provide generous tax incentives, including investment tax incentives. In particular, tax provisions under Pillar 2 are aimed at ensuring a minimum level of effective taxation. This implies that the maximum level of tax benefits that governments can provide to foreign investors will be limited because other jurisdictions (e.g., in the case of the application of the IIR, the ultimate parent jurisdiction) will be able to apply a top-up tax to the low-taxed profits in order to bring effective tax rates at the jurisdictional level up to the minimum rate.

It appears that it is assumed that developing countries with a low tax rate (perhaps being their only competitive factor due to lack of natural resources etc) will not suffer from reduced investments since their governments are assumed “to respond flexibly and adapt their policy mix to the[se] structural changes in the international tax environment if there is a concern about the level of innovation in their countries”.[6]

The elimination or reduced effectiveness of their tax policies are according to our view however likely to reduce the attractiveness of these investment locations and lead to less capital being invested. This will have a negative impact on jobs and growth. Such an effect also points in the direction that the assumed investment elasticity is too low.

The limitation on tax competition will affect not only harmful tax policy practices but also legitimate sovereign tax policies. There is a cost for such an effect, in particular for the citizens of such jurisdictions.

Trade Implications

The Impact Assessment deserves praise for analysing the effects of trade tensions. Clearly, the introduction and retention of DSTs will have a very negative impact on the world economy.

The reallocation of tax revenues on both pillars may however also lead to tensions between countries. This is not elaborated upon in the Impact assessment. The new rules may lead to effects on tax and tariff developments and they will likely lead to multiple taxation claims on profitable companies and a non-recognition of losses.

---

[6] Page 167 of the Impact Assessment.

The OECD has however spent considerable efforts outlining methods for dispute prevention and dispute resolution.

Conclusions

The methodology and assumptions made underestimate the effect on investment, innovation and growth and overestimate the revenue gains. The impact on government behaviour, tax competition, businesses' investment decisions and administrative costs all point in this direction. Smaller countries and developing countries may encounter a larger share of the costs than the size of their economies justify. This calls for simplification to the maximum extent possible.

Concluding Remarks

Our Confederations recognize the difficulty in changing international taxation rules of how to divide tax revenues among countries in such an extremely short time period. We call for clarity and recognize that there will be departures from the generally agreed concept of value creation. The new rules must however also be based on principles generally accepted. These rules or principles are not clear and should be made clearer.

The introduction of unilateral measures in many jurisdictions has fuelled the debate on the necessity of reaching international consensus. When the Inclusive Framework reach an agreement, such an agreement must also require the removal of any current unilateral measures in force and a political commitment by the members not to introduce such measures in the future.

Furthermore, agreement on a swift and simultaneous implementation through the MLI, or a similar instrument, is of utmost importance. Efficient dispute prevention and resolution mechanisms and a commitment by all Inclusive Framework members to accept mandatory binding arbitration, must be a prerequisite to an agreement on Pillar 1 and 2.

Pillar 2 may recover some of the corporate tax losses of residence countries, but the cost of capital is likely to increase. This will hurt investment and job creation globally but may be more pronounced in net exporting countries like ours. The OECD has often considered the corporate income tax the most harmful tax to growth and jobs. Any increase in effective tax rate will affect job prospects negatively and low-income earners are likely to be the most affected.

Finally, we note that what started out as a project to deal with the tax challenges stemming from the digitalization of the economy, may, according to the impact assessment, result in a proposal were approximately 90 per cent of the new tax

revenue will come from a global minimum tax and business activities not linked to the digitalization of the economy.

On behalf of the Confederation of Swedish Enterprise

Claes Hammarstedt	Krister Andersson
Director of International Tax Policy	Advisor

On behalf of the Confederation of Finnish Industries EK

Anita Isomaa	Penna Urrila
Tax Director	Director, Economic Policy

On behalf of the Confederation of Danish Industry

Jacob Bræstrup	Sune Hein Bertelsen
Director of Tax Policy	Head of International Tax

On behalf of the Confederation of Norwegian Enterprise

Ellen Mulstad
Tax lawyer