Technology Industries of Finland

11/12/2019

To Tax Policy and Statistics Division, Centre for Tax Policy and Administration

Comments on the OECD's Secretariat Proposal for a "Unified Approach" under Pillar One

Technology Industries of Finland ("TIF") is thankful for the possibility to comment the proposal and would cordially wish to draw the attention of the OECD to the following.

TIF represents Finnish technology industries and has over 1,600 member companies, sizes varying from small SMEs and start-ups to world leading MNEs. The technology industry is comprised of five sub-sectors: electronics and the electrotechnical industry, mechanical engineering, metals industry, consulting engineering and information technology. Technology industry is the most important export industry in Finland, with operations constituting over 50 % of all Finnish exports and responsible for 70 % of all investments in R&D carried out in Finland. Over 300,000 Finns work in technology companies, while a total of around 700,000 people work in the technology sector directly or indirectly (of a total population of 5,500,000).[1]

Key Messages

- Technology Industries of Finland supports the hard work of the OECD to find a global solution to address the tax challenges arising from the digitalization of the economy. Even though the schedule is immensely tight, the **progress made gives trust that a global solution can be found and agreed upon.**

- There should be **explicit agreement** that all existing and proposed **unilateral tax measures are abandoned when the global solution is agreed upon**.

- TIF supports **clear definitions** on which business models are out of scope. Defining and identifying the scope specifically and sustainably is a difficult task. The scope must be clear enough to enhance certainty and prevent disputes. There should not be ring-fencing of only certain types of businesses. One main rationale in the Unified Approach is to allocate more taxing rights to the market jurisdictions and concentrating on customer data collecting and exploiting businesses. As the market jurisdiction is where the consumer/user is, **TIF supports building on the consumer facing business scope limitation.** For the same rationale, **TIF supports carving out industrial, purely B2B business and the already proposed carve-outs. The carve outs should be applied also on a business line basis,** when requested.

- **TIF supports creating a formulary approach** upon which the companies can easily calculate whether they are included in the scope, and it will likely provide certainty and reduce disputes, which are costly for the companies but also to the countries, especially the small and developing.

- **TIF welcomes the 750 million euros threshold to carve out SMEs, but a higher threshold** of the group revenue **could be applied.** The ownership threshold is an important factor for SMEs. **A company should not be considered a part of the MNE group unless the ownership share is >50 %.**

[1] For further information of TIF's member companies, please see https://teknologiateollisuus.fi/en

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- **The market specific limit for the new tax model should be kept reasonably high.**

- **Changes to taxation must not result in double taxation**. All changes must be linked to effective dispute resolution methods.

- **Also, the taxation procedures must be effective**. Reporting, collecting and crediting of tax should be as efficient and simple as possible.

- TIF proposes the following means to make taxation procedures more efficient as well as limiting double taxation and disputes:
    - **Centralized reporting method**, for example similar type as the EU VAT MOSS or the CbC-reporting.
    - Typically, market country is also the source country under traditional WHT rules. Therefore, the countries could agree to **abolish WHT**.
    - **Digitalisation and automation of taxation procedures could lead to notable savings** both to companies and tax administrations, as well as reduce tax gaps and tax evasion.
    - **Accessible multilateral mandatory binding arbitration.** To be effective, adequate resources and clear deadlines for the processes should be introduced, binding also to the authorities.
    - **A database of the MNEs calculations kept by the OECD.**
    - Dispute resolution mechanism which includes an **organization at the OECD level** to accomplish **binding and effective multilateral dispute resolution.**
    - In case segment/regional profitability is considered, is should be done respecting the MNEs financial calculations. To avoid tax disputes in multiple countries, **only the headquarter jurisdiction should be entitled to audit/certify** any agreed formula.
    - Use of dispute preventive tools, such as **Pre-emptive Discussion and Cross-Border Dialogue also on a multilateral basis** to enhance certainty and prevent tax disputes.
    - **Use of ICAP and joint audits also on a multilateral basis.**

- **Any tax on the activities of corporations should be linked to profit, not revenues.**

- **Treatment of losses must be solved,** considering both in situation of periodic losses and tax loss carry forwards related to corporate income tax in jurisdiction surrending taxable income. TIF suggest using overall group profitability as basis for taxation. **Group profit would allow use of a "tax cap" as method of exempting loss-making groups from profit taxes**.

- **The percentage of routine profit should be set high enough (>15%).** In order to mitigate controversy and provide flexibility in application, it would be recommendable to also **introduce safe-harbor rules for around the percentages**.

- **New nexus should only be used for the purposes of the Unified Approach, for reallocation purposes only.**

- If using country specific thresholds, the **cost of reporting tax should not be higher than the tax itself.**

- **Any elements of the possible formula would have to be indisputable, fair and recognize the value creators of digital economy.**

- The final proposal should include a clear definition on what is the hierarchy between routine remuneration and amounts A, B and C. **It would also be appropriate to clearly establish which functions are remunerated under routine profit to avoid multiple allocation on sales and marketing functions potentially contradicting with their value creation.**

- **TIF supports the decision to build Amount B and C on current TP rules**, as that will provide certainty.

- Current TP rules based on OECD BEPS work put significant emphasis on value creation. **Thus, this should be reflected in the current work and distributor and marketing jurisdictions must not be rewarded in excess of their value creation and potentially** with Amounts A, B and potentially even Amount C.

- **Gross revenue based withholding taxes should be uniformly rejected.**

- **The rules need to be clear on which company or permanent establishment is the actual tax subject and the "surrender state or states".**

- **The final proposal must be fair and sustainable to all countries (also small and developing)**.

- If the the new nexus rules or allocation key includes user-based elements, **TIF expects clear rules how the consumer data is collected and used, without jeopardizing the principle of data security**.

- **The global taxation system must be considered in its entirety** and VAT or other sales taxes should also be discussed.

1 Scope

Amount A is proposed to focus on large "consumer (incl. user) facing businesses". Even though defining and identifying the scope specifically and sustainably enough is a difficult task, TIF understands the rationale behind this and **supports building on the consumer facing business scope limitation.** There seems to be a consensus that the Unified Approach (UA) should result in allocating more taxing rights to the market/user jurisdiction, where the consumers and users are. Thus, concentrating on B2C business is understandable.

A description included in the UA further clarifies the reasoning behind trying to draft the scope to target consumer facing businesses. The intention is to recognize the digitalized businesses which "can project themselves into the daily lives of consumer (including users) and interact with their consumer base without a traditional physical presence in the market" and that this is "most relevant for consumer facing businesses for whom consumer engagement and interaction, data collection and exploitation, and marketing and branding is significant".

However, the UA includes various scope descriptions, which widen the scope to some B2B business models. Even though it is understandable that not all "consumer/user facing business" is B2C

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services and product sales, this makes the scope limitation unclear. **The scope must be clear enough to result in unified interpretation, to enhance certainty and prevent disputes**. There should not be ring-fencing of only certain types of businesses. As has been said by the OECD as well, there is no digital economy and all economy is digitalizing. Thus, using "digital businesses" as a definition is not possible. Detailed scope limitations based on business models do not make a simple model.

1.1 Interaction with consumers/users

Defining the "consumer/user facing business" is one of the most difficult questions in the Unified Approach.

- Also "highly digitalized businesses which interact remotely with users, who may or may not be their primary customers" would be included in the UA scope. **Tracking the location of the consumer/user includes personal data protection questions.** Please see chapter 4 for more analysis on data privacy.
- Most of MNEs tend to have B2B, B2C and B2G business. Allocating sales between these sales is costly and burdensome.
- If the MNEs products or services are sold to consumers only through a chain of third part distributors and wholesalers, is it considered consumer facing for the MNE?
- How would integrated products or services be considered? For example, if the MNE sells parts for another company (B2B), which uses the parts to build consumer products (B2C)? Is the first MNE considered to be "consumer facing"?
- Concerning the new nexus rule, there is a comment that "the revenue threshold would also take into account certain activities, such as online advertising services which are directed at non-paying users". Identifying a non-registered, non-paying user might be close to impossible. **How will the non-paying users affect the new nexus threshold**, as they do not generate money to be tracked. Will the number of users be estimated to generate an imaginary pre-agreed amount of value to be added to the revenue?

1.2 Defining the MNE group

- Thresholds for consolidation may vary in different jurisdictions. There should be clear definition which consolidation method to be used and an agreement that if this method is used, no country can challenge the consolidation.
- The ownership threshold is an important factor for SMEs. **A company should not be considered a part of the MNE group unless the ownership share is >50 %.** Should the limit be low (e.g. 25 %) Unified Approach rules would apply, even though the MNE group company is an investor in a local SME. Being liable to report and allocate taxes (with the risk of tax increases) without proper access to all the group level financial data would be unreasonable.

1.3 Covering different business models (including multi-sided business models) and sales to intermediaries

- Including sales to intermediaries creates significant problems as there is often no way for the MNE to know where the intermediaries/third party distributors sell the products onwards. If the Unified Approach was adopted, third party sales to intermediaries should be excluded and the intermediaries should be the tax paying subjects regarding their own sales to consumers.

1.4 The size of the MNE group, taking account of fairness, administration and compliance costs

- To ensure that the new tax system does not result in a too burdensome compliance and administrative costs for the SMEs, **TIF welcomes the 750 million euro threshold carving out SMEs.**
- As the Amount A model is new and goes beyond the current arm's length principle -model, a **higher threshold on the group revenue figure could be in order** at first. Evaluation on the functioning of the model could be made after a couple of years and consider the whether the revenue threshold needs to be adjusted.
- A higher threshold could also be fairer to MNEs providing physical products. Often if these companies sell products in a relatively high number of countries, the volume is scattered as the size of any particular market is typically very small compared to the total global volume. In a way this is the opposite to one of the OECD's identified elements of digitalized economy "scale without mass".
- **Therefore, also the market specific limit for the new tax model should be kept reasonably high.** Should only a (relatively low) group level revenue matter, the compliance cost per sales euro as well as total tax burden will become unreasonably high for smaller markets, resulting in an inability for the company to provide products for sale in that market.

1.5 Carve outs

- As mentioned above, the UA describes the scope being drafted to target "consumer facing businesses for whom consumer engagement and interaction, data collection and exploitation, and marketing and branding is significant".
- This **clarifies the reasoning for the proposed carve outs. Extractive industries and commodities** do not have significant consumer interaction, data exploitation nor are they relying on strong branding.
- For the same reasons **industrial B2B businesses should be carved out**. They do not have significant consumer interaction, do not collect, exploit or sell consumer data.
- Clearly defined, specific exemptions would provide certainty to taxpayers and tax authorities.
- **The carve outs should be available to be applied also on a business line basis.** Example: MNE has four business lines. Currently profitability of each business line is calculated/monitored separately, and each business line has different transfer pricing model. Three out of four business lines will potentially be affected by the new rules, one will most likely be carved out (extractive industry) and its market jurisdictions differ significantly from the other three business lines. The extractive industry business line should be fully carved out.

2 New nexus

- A new concept of enhanced nexus is introduced in the Unified Approach. A new nexus will grant taxing rights to countries where companies do not necessarily have a permanent establishment, which will require changes to tax treaties and countries' domestic law.
- **New nexus should only be used for the purposes of the Unified Approach, for reallocation purposes only.** It should not result in other obligations linked to it such as nexus for VAT purposes, or any other non-tax or regulatory purposes. This should be explicitly said in the treaty changes creating the new nexus rules, such as a stand-alone treaty.

- Extensive compliance requirements should be limited in the market jurisdictions. In addition, the information that the MNEs are required to collect and provide should be within reasonable limits.
- There could be e.g. reasonable thresholds based on percentages e.g. no allocation if sales are under X% of global sales. Example: An MNE typically has 100+ market jurisdictions. Out of MNE's 100+ market jurisdictions top 10 market jurisdictions may make e.g. 80% of global sales (respectively top 20 may make over 90% of global sales). Rest of the jurisdictions may each have clearly less than 1% of global sales and there is likely to be some annual variation within the smallest jurisdictions (whether there is any sales to these jurisdictions during each FY). In addition these <1 % global sales countries have annual variance and some of them do not have sales every year.
- Limiting high compliance costs with the above mentioned model would admittedly mean, that the smallest amounts of sales are likely to be in smaller or developing countries, making this model less appealing for them. Another way to limit burdensome compliance costs would be to rise the revenue threshold from the 750 million, so that smaller groups would be left outside the scope.

2.1 Defining and applying country specific sales thresholds

- **If using country specific thresholds, the cost of reporting tax should not be higher than the tax itself.**
- Not all profitable companies have a big financial team. Having tens of new taxable jurisdictions would result in either hiring a lot of more financial personnel only for this purpose or paying a hefty amount to tax consultants, burdensome especially for SMEs.
- A threshold representing an average compliance costs, could be a limit under which no tax will be due.

2.2 Calibration to ensure that jurisdictions with smaller economies can also benefit

- Having different thresholds in every country is in a way fairer for the smaller and developing countries. For e.g. Germany (88 million citizens) a sales threshold triggering a new nexus can be higher than in e.g. Malta (250.000 citizens).
- For an MNE however, country specific thresholds would result in more compliance costs due to more nexuses emerging based on country specific, altering limits.
- Reporting in all relevant countries, applying local rules and e.g. in local language increases the administrative costs.
- Other way to make the compliance costs less burdensome, is that the tax authority of the parent company's residence jurisdiction (such as EU VAT MOSS) or e.g. platform providers (such as in VAT and sales taxes) would collect and distribute the taxes to each country.
- A centralized reporting would also prevent possible tax disputes.

3 Calculation of group profits for Amount A

- **TIF supports having a simple way calculating whether an MNE is in the scope.** In order to avoid a number of unnecessary steps to prove whether an MNE has exceeded a taxable threshold in a particular country, any analysis should start with a simple test of the size of the whole MNE and its profit, and should the entity not exceed these levels, no further analysis should be needed. Thus, **using the public, consolidated financial statements for identifying the profit margin seems like a functioning way**.

- Accomodating 134 local GAAP reguirements would be impossible. Currently all EU MNEs must prepare an IFRS financial statement. Thus, **standardised adjustments should not be made but IFRS financial statement could be taken as the base for calculation**.
- Turnover limits would need to be adjusted so that there is **a limit also for turnover subject to Unified Approach**, and not only for turnover of the group. Otherwise even tiny amount of turnover subject to the UA would require heavy calculations without relevant impact to allocation of income.
- **If segmentation by business line/regions is utilized, there should be a presumption in favor of the taxpayer's segmentation** and a prohibition against governments asserting their own segmentation to enhance returns to their jurisdiction. If authorities in one market country conclude that group or segmented profit is incorrect, then profit allocated to other market country and profit in IP-owning entity would need to be adjusted too. This would sacrifice simplicity, administrability and certainty from use of accounting profit.

In the Unified Approach there is no specification what profit figure should be used as the profit (e.g. group/business line/segment profit, EBT, EBIT, EBITDA, gross profit). In order to enhance certainty, the figures used have to be clearly defined:

- In principle, **financing expense (or income) should be deducted from profits** (or income added) when group profit is calculated for purposes of Amount A. Otherwise market countries would tax the income and only IP-owning entities would carry the financing expense. Furthermore, outcome can be disproportional and unjust for taxpayer.
- Example: Assume that group has sales of 100 and operating profit of 10 (margin 10%) and that routine profit is 5, leaving residual profit of 5 to be allocated to market countries. However, the group has financing expense of 10, leaving profit before tax of 0. Amount A is 5, and that gets taxed in market countries with 20% rate, ie. tax expense is 1. The company made pre-tax profit of 0 and tax expense of 1, so post-tax loss is 1. If financing expense would be 5 instead of 10, the profit before tax would 5 and that would be fully taxable in market countries.
- In practice, the "group profit" for the purposes of Amount A should be profit before tax. **Alternatively, the level of routine profit could be set adequately high (e.g 20%),** so that the exclusion of financing expense form "profit" would not distort the profit allocation.

3.1 How can an approach to calculating group profits on the basis of operating segments based on business line best be designed? Should regional profitability also be considered?

- Group profit might not reflect the profitability of different business lines i.e. some business lines might be profitable and some loss making.
- MNEs operating in consumer business practically always have both B2B and B2C business, in all business lines, and in all countries they operate. The group reporting and financial statement segmenting does not follow this granularity. Typically, MNE reporting is based on the need for group consolidation of legal entity result, which is basis for both the group's annual statements as well as legal entity level statutory financials and tax calculations (financial reporting). The other type of need is management reporting, for which the entity for business control reasons defines the reporting dimensions and granularity. Regarding the reporting required by this proposal, neither of the two reporting types will suffice, instead, the profit split will require an entirely separate and new additional third layer of reporting.

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- Typically, for management reporting purposes, businesses may choose to follow business line/market/product category or other reporting dimension at net sales level, gross margin level, or EBIT level. Apart from segment reporting for external financial reporting purposes, it is quite uncommon to divide cost down to EBIT level, not to mention "profit before tax" level which is practically never done for any other than legal entity level reporting purpose. It would therefore be a huge additional administrative burden to allocate profit and all cost per business line (however those may be defined), between B2B and B2C, and further per country. At best, the resulting EBIT would be an estimated allocation not based on audit trail sufficient for being a basis for taxation (contrary to legal entity level accounting and reporting).
- An important notion here is that the **administrative cost is not limited to making additional calculations and filings, but the main burden would result from a significant investment need to alter IT systems to cater for the new type of accounting/reporting.** This investment would have nil business value add.
- Therefore, in case regional profitability is considered, is should be done **respecting the MNEs own segment/regional financial calculations.** To avoid tax disputes in multiple countries, **only the headquarter jurisdiction should be entitled to audit/certify any agreed formula.**

4 Determination of Amount A

- In determining of Amount A, a formulary approach would be used to identify deemed residual profits in order to allocate a portion of those profits to market jurisdictions based on an agreed allocation key (such as sales).
- **TIF supports a formulary approach** to simplify the calculation and to hopefully avoid disputes. Principle to only include a portion of non-routine/residual profit is aimed to leave profits from routine functions excluded. However, TIF is of the opinion that it should be clearly stated that trade intangible returns are out of scope and excluded from the simplified formula.
- **The percentage of routine profit should be set high enough (>15%):**
    - If the trade intangible routines cannot be excluded from the formula, higher threshold would better secure that trade intangible returns are out of scope.
    - Typically, the profitability of an MNE varies between business lines and countries. An acceptable, "one size fits all" -split between routine and non-routine/residual profit is difficult to determine.
    - High threshold would target "super-profits".
    - Would emphasis that the routine remuneration is comprehensive and "at arm's lenght".
- Different percentages could be applied to different industries or business lines. In order to mitigate controversy and provide flexibility in application, it would be recommendable to also **introduce safe-harbor rules for around the percentages**. If the agreed routine profit is 15% from sales and allocation of non-routine 20% to market countries, the safe-harbors could be between 12-18% for routine and 15-25% for allocation to market countries.
- It is also necessary to clearly establish which functions are remunerated under routine profit to avoid multiple allocation on sales and marketing functions potentially contradicting with their value creation.
- It is unclear what would be the allocation key when dividing portion of the non-routine profits to the market jurisdictions. **Any elements of the possible formula would have to be indisputable, fair and recognize the value creators of digital economy** (e.g. R&D, intangible assets).

Treatment of previous year non-routine loss

The implementation of Unified Approach can lead to unreasonable outcomes for tax payers and countries. When Amount A thresholds are reached, market countries would have right to tax non-routine profit, but they have not participated in carrying the underlying expense and risk. The situation may occur when:

- The UA is implemented by the jurisdictions for the first time
- scope of the UA captures taxpayer later on, or
- the non-routine profit is first below A threshold and later exceeds it.

The outcome appears to be unbalanced, and the **final proposal should include clear guidance on treatment of losses. TIF suggests that also the following model could be explored:**

- Previous years non-routine profit or loss is calculated at the time when Amount A would allocate non-routine profit to market countries.
- The previous year deficit of non-routine profit (difference between Amount A threshold and actual non-routine profit) is split between market countries and principals using the same percentage as non-routine profit.
- Previous year non-routine deficit is allocated to market countries and further between countries based on same method as profit (e.g. sales or users).
- Country specific non-routine profit deficit would be deducted from country's non-routine profit.
- The model requires that coutries agree on recapture period (e.g 10 years) and time period during which the past year deficit can be utilized.

Further use of group profit to increase fairness and boost investment

- Current tax rules are based on separate legal entities, while the overall group profitability has not been used as basis. This results in a situation where the group is in a tax-paying position, even though the group is loss-making (either as a result of withholding taxation or profit taxes made by profitable legal entities. Business can face effective tax rate of over 100%, which has the same negative implications as corporate income taxes payable by loss making businesses. Levying corporate taxes to loss making business hinders ability to recover from crisis, to grow and invest especially in start-ups, scale-ups and fast-growing and loss-making disruptive businesses and it is fundamentally unfair, as loss making business may not have capability to pay the tax.
- Amount A targets to assess and confirm the group profit. The use of group wide profitability could be expanded to prevent taxation of loss-making group companies. Group profit could be used as a cap to profit tax liability, so that the tax liability would never exceed the amount of group profit. Technically, the "Tax cap" can be achieved by calculating the tax per country as proportion of taxes (corporate income tax and WHT) per country.
- Example: Assume group of companies, with principal, two limited risk distributors and sales subject to WHT in fourth country. Group profit (tax cap) is 5 and total taxes 10. The tax per country after capping is presented below.

Group profit	**5**	5
Country	**Tax assessed (CIT/WHT)**	**Tax after capping**

A (Principal)	0	0,00
B (LRD CIT)	5	2,50
C (LRD CIT)	3	1,50
D (Sales WHT)	2	1,00
Total	**10**	**5**

- The use of tax cap requires information on taxes assessed per country, which should be achievable as part of centralized process discussed under dispute prevention (chapter 7) below. Application of tax cap could be optional to taxpayers.

Data privacy

- If the new nexus rules or allocation formula includes consumer/user based elements, **TIF expects clear rules how the consumer data is collected and used, without jeopardizing the principle of data security**, for example GDPR-rules in the EU.
- Concerning the new nexus rule, the revenue threshold would also take into account certain activities directed at non-paying users. Unclear is how will the non-paying users affect the new nexus threshold, as they do not generate money to be tracked.
- The OECD's Unified Approach proposes that a share of non-routine profits would be allocated to the market jurisdiction based on an allocation key, using variables such as sales. Other variables discussed could be e.g. the amount of users. If the MNEs tax liability would be triggered based on where the customer or user is deemed to be located, it would require location and other personal data to be collected and stored for an indefinite time.
- If the market jurisdiction's taxation rights would be allocated based on the amount of users (and consumers), the **countries would have an incentive to gather location data of users**. At a time when society is questioning the amount of personal data that is retained by companies, it seems to be quite a surprising course to take – to base the calculation of a new tax on personal location data, requiring companies to store vast amounts of personal data for tax compliance purposes.
- Any tax model should be coherent with privacy legislation (such as European GDPR and like in other countries) and its principles such as data minimisation and data protection by design. If personal data needs to be processed to allocate taxes, it should be carefully considered what would be the minimum dataset subject to processing and how to minimise risks incurred by the processing. **All the data processed needs to be strictly necessary to facilitate taxation.**
- The scope of personal data is very broad, eg. **name, email address or IP address are regarded to constitute personal data**. IP addresses may in several cases serve as location identifiers.
- Linking taxation to user location data would in principle mean banning privacy enhancing technologies. If, on the other hand, data security is considered important, the users must be allowed to use applications blocking tracking (eg. VPN-aplications). VPN allows a user to change the virtual (IP) location.
- If the OECD model would require companies to store big amounts of data solely for taxation purposes, this will subject companies to new **risk-positions based on that data**. Mitigation of these risks would incur **additional cost** - not related to companies' day-to-day business.
- The model should be based on data that the companies process as part of their day-to-day business actions.

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5 Elimination of double taxation in relation to Amount A

- As described in the Unified Approach considering this question nr. 5, the existing domestic and treaty provisions relieving double taxation apply to multinational enterprises on an individual-entity and individual- country basis.
- Until now and also as a result of the BEPS-changes, there has been a strong message to allocate profit to the country where value is created. Amount A goes beyond this and allocates more taxation right to the market jurisdiction. It is **unclear in which order the compensation will be done.**
- If the traditional transfer pricing rules are applied first for routine profit and possibly the Amount B and Amount C allocates more taxable income to the jurisdiction of the distribution and marketing functions, applying also Amount A might lead to further compensation to that market jurisdiction in addition to the appropriate arms length remuneration already allocated based on value creation.
- Difficulties in determination of the legal entity liable for tax will cause more risks for double taxation. Should a group have several sales channels in a country, the proposal would multiply the number of tax liable entities and tax filings per country. For example, the local entity acting as a retailer (B2C) and wholeseller (B2B) locally would pay tax based existing rules and on its marketing and distribution function, and on other functions (amounts B and C). Additionally, a foreign entity/entities would be liable to file and pay tax on the sales of the local entity based on amount A. In addition to that, a foreign entity/entities selling directly to consumers online in the country in question would file and pay tax separately on amount A. Lastly, should there be unrelated distributors in the country, the foreign entities selling to those distributors would be taxed on the sales based on amount A. The final proposal should include clear specification on which is the taxable legal entity.
- **Difficulties in determining the entity and jurisdiction which will surrender taxable income in favor of market jurisdictions will lead to complex multilateral disputes**. The UA is based on assumption of one principal entity with centralized business (and transfer pricing) model. In practice, even in centralized business (and transfer pricing) models there might be several principals in multiple jurisdictions. In decentralized business (and transfer pricing) models there is no single entity/jurisdiction entitled to residual profit under existing transfer pricing rules based on value creation.

- **<u>Please see chapter 7 for further suggestion of dispute resolution and prevention methods.</u>**

<u>Withholding taxes</u>

The proposal references the notion of withholding taxes. **Gross revenue based withholding taxes should be uniformly rejected.** As with extraterritorial VATs, companies should be responsible for voluntarily reporting and paying the agreed Unified Approach taxes. This reporting and payment should not have any consequences for any purpose outside of the agreed UA taxes.

WHT on services and royalties is in many ways a flawed tax:

- WHT is not based on profitability of the taxpayer but on certain transactions. As a result, loss making businesses may suffer from it, and tax burden on business can exceed profit before tax (tax rate exceeds 100%).
- WHT compliance is heavier than profit-based taxation. Correct application of WHT requires compliance in larger number of countries (source countries) compared to home country taxation where compliance takes place in one country; confirmation on the residence

country of recipient requires certificates and application of beneficial ownership rules, principal purpose test and/or limitation on benefits rules; crediting of WHT requires documentation of taxes paid and the reconciliation to accounts payable and accounts receivable can be extensive exercise, especially if the payer and recipient are independent parties.
- WHT is prone to controversy between source and residence country, especially in the area of software.

Application of the Unified Approach and Amount A may increase these challenges:

- It is possible that income is subject to WHT, but residence country rejects WHT credit, e.g. by claiming that WHT is not in accordance with residence country royalty definition.
- Furthermore, it is possible that the same income becomes also subject to the UA, and volumes and profitability also exceed Amount A thresholds. It is possible, that there is no country, which would allow the income to be exempted or tax credited under Amount A. This would be the outcome e.g. if countries disagree on correct legal entity, which should eliminate double taxation under Amount A, or if they disagree on any other parameter of Amount A, resulting to disagreement of correct amount of Amount A or country otherwise eliminating double taxation does not accept the documentation prepared by tax payer.
- Loss-making companies will not have the capacity to cover for the additional tax burden, which will force them to increase their prices towards their customer or cut other expenses, such as investments or employment costs. Depending on what type or transactions would be covered in the model, individuals might become a group targeted.
- Obligations to report all the payments to the tax authorities and proceed with the myriad payments, repayments and tax returns of related taxes concerning would result in massive addition to the work load of the tax authorities and significantly disincentivise cross-border e-commerce.

It is therefore possible, that the income is subject to quadruple taxation.

However, these risks can be mitigated.

- Unified Approach suggests that countries agree to expand taxation right of market countries. Typically, market country is also the source country under traditional WHT rules. Therefore, the **countries could now agree to abolish WHT altogether**. That would remove major source of compliance issues, double taxation, controversy and unfairness of international taxation and thus result to increase of international trade, investment and welfare.
- If countries are not willing to take this step, they could still agree to abolish WHT in case where the business falls under the scope of the UA. Or they could agree that to the extent Amount A rules allocate income to a market country, then the same income would not be subject to WHT. Reason for collecting profit tax under the UA and Amount A instead of WHT is, that profit tax is fairer (no taxation of loss-makers or tax rate exceeding 100%), profit tax is easier to administer, and it is based on Inclusive Framework consensus view of profit allocation to markets.

5.1 Identifying relevant taxpayer entitled to relief

- Not all entities operate in a centralized model where one of the group entities is a risk taking entity and others limited risk entities, distribution of profits determined accordingly. Should some country in the proposed approach be determined to be entitled to additional tax, the deducting/crediting end is not necessarily a single principal entity hosting the group's

residual profit. Instead, the entity having remotely sold to the taxing market may not have sufficient level of taxable income itself to credit the additional foreign taxes. This may of course happen in IP owning principal companies themselves should there have been investments required to create or maintain the products, services or brands the sales of which is subject to new foreign tax.

- Based on the experience so far from jurisdictions and administrations applying new BEPS based taxation principles, it is optimistic to expect that countries among the OECD would reach the required level of consensus for an effective elimination of double taxes or deduction of current or prior year losses.
- **The rules need to be clear on which company or permanent establishment is the actual tax subject.** The calculation whether the rules are applicable is proposed to be done at a group level. However, there is no clear suggestion how the tax would be accounted or collected in practice.
- Due to the reallocation of taxation rights in all of the Amount A-C methods, some countries will be losing tax revenues. When identifying the taxpayer entitled to relief, there **should also be a clear identification of the "surrender state or states".** It should be clear which country is responsible to credit or exempt the reallocated tax and what taxation procedures are used to make this process as simple and effective as possible.

5.2 Building on existing mechanisms of double tax relief

- An **accessible multi-lateral mandatory binding** arbitration would be somewhat functioning dispute resolution method. To be more effective, **clear deadlines** for the processes should be introduced, binding also to the authorities. Countries should also allocate **adequate resources** for dispute resolution purposes.
- Given the existing but very slow APA and MAP mechanisms, and the fact that the proposed approach would multiply the number of jurisdictions participating in a single dispute resolution case, any current mechanisms will not be sufficient to prevent MNE's in scope from double taxation i.e. excessive effective tax rate increases and cash taxes. Thus, new methods will have to be considered.
- There are differences in group entity profitabilities. Not all entities operate in a centralized model where one of the group entities is a risk-taking entity and others limited risk entities, distribution of profits determined accordingly. Should some country in the proposed approach be determined to be entitled to additional tax, the deducting/crediting end is not necessarily a single principal entity hosting the group's residual profit. Instead, the entity having remotely sold to the taxing market may not have sufficient level of taxable income itself to credit the additional foreign taxes. This may of course happen in IP owning principal companies themselves should there have been investments required to create or maintain the products, services or brands the sales of which is subject to new foreign tax.
- Tax authorities should have the responsibility to distribute the reported and paid taxes to other countries. A similar process is used for VAT in the EU: MOSS (mini-one-stop-shop). This would eliminate double taxation and tax disputes.
    - There is already a wide information exchange of information responsibility between the competent tax authorities and the co-operation of the authorities is being supported and increased.
    - Tax reporting requirements and deadlines varying in each country. Compliance costs and a risk of non-compliance could be lesser if MNEs wouldn't have to report in all jurisdictions.

- **<u>Please see chapter 7 for further suggestion of dispute resolution and prevention methods.</u>**

6 Amount B

- Amount B would be based on the current transfer pricing rules and arm's length principle. **TIF supports the decision to build on current TP rules**, as that will provide certainty.
- Fixed remunerations used with existing transfer pricing mechanisms could prevent uncertainty regarding acceptable profit levels of group entities' distribution functions. However, even a simple distribution model is rarely the same in all businesses and companies, so it would require a significant level of faith from jurisdictions to agree to certain fixed remuneration levels, and simplification / change requirements to current substance-based profit allocation principles.
- Agreeing a fixed percentage will be complex. One percentage will not be applicable in all situations and all business models. Thus, **fixed levels ("safe harbors") could be used instead.**
- Different countries have in the past applied local market or cost level -based factors to required profit levels. Changing the method will result in a completely different compensation, although the percentage used is the same. The final report should also include a clear definition on what method will be used when remunerating the distributor and marketing jurisdictions, not just the percentage.
- **The final proposal should include a clear definition on what is the hierarchy between routine profit and Amounts A, B and C.**
- In digitalised businesses value is created through research and development. BEPS Actions 8-10 put significant emphasis on value creation. **Thus, distributor and marketing jurisdictions must not be rewarded in excess** with Amounts A, B and potentially even Amount C.
- **Amount A should be the guaranteed minimum** that a country can expect for sales into the country. If a business is already in a country and compensating the country via Amount B and Amount C, at or in excess of the OECD Amount A guaranteed minimum, no additional return will be allocated to the market.
- The definition of Amount B activities must be clear to prevent double counting with Amount C.

7 Amount C / Dispute prevention and resolution

- Amount C would grant the tax payers and tax administrations the ability to demand a profit higher than the fixed return contemplated under Amount B, by arguing that there are marketing and distribution activities exceeding the baseline level.
- To avoid double taxation, new dispute prevention and resolution tools must be used. TIF will comment only these tools, not the concept or calculation of Amount C.

- Any initiatives possibly resulting to dispute prevention are welcomed. **TIF also supports use of ICAP** (OECD International Compliance Assurance Programme) **and joint audits on a multilateral basis.**
- The ICAP has potential, in case it can be scaled up. At this point only a couple of companies and some 10-15 countries (Finland including) are covered.

<u>Centralised reporting and payment of taxes process with a dispute resolution panel</u>

- To avoid excessive compliance costs, a centralized process, where taxpayers file calculation of Amount A with HQ tax authorities, like is done currently with CbC-reports could be used. HQ tax authority would submit the calculation to **OECD, which would maintain a database of the calculations** and share them with other Inclusive Framework Members.

In case a member would like to challenge the calculation of a taxpayer retrospectively, it would inform the OECD and other Members. This would initiate the mandatory binding arbitration between relevant members. That would allow other members to indicate/express, if they accept the adjustment or not. Process would also allow impartial dispute resolution panel to lead the process towards all relevant members.

- Centralised process would have several benefits:
  - It would be cost efficient for both tax administrations and taxpayers.
  - It would allow timely resolution of disputes.
  - Taxpayer would be involved and protected from clearly ungrounded tax decisions. **Panel or other OECD body could be entitled to reject claims,** which lack the legal merit, in order to limit the number of cases to be handled in more detail.
  - Tax payers could ask for advance rulings, meaning dispute prevention. The panel could decide beforehand, e.g. if the taxpayer subject to the UA or not.
  - Panel could issue tax exemption decision for loss makers and taxpayers with assessed taxes exceeding group profit.
  - OECD could issue guidance and publish panel decisions attracting broader interest in anonymized format.

Taxation procedure tools and real time economy

The OECD proposals have all requested for means to enhance effective tax administration. Technology Industries of Finland supports the OECD to call for use of digital taxation tools and procedures. **Digitalisation and automation of taxation procedures could lead to notable savings** both to companies and tax administrations, as well as reduce tax gaps and tax evasion. In addition, **centralising taxation procedures to the home country of the company/group** (like MOSS: mini-one-stop-shop in the EU for VAT matters) would minimise the administrative burden significantly.

The Finnish Tax Administration is the first country in Europe to combine all taxation software and processes into one system. The savings for the Tax Administration alone is estimated a total of approx. 6,5 % decrease in the total annual costs of the Finnish Tax Administration. The taxation procedures have been digitalised almost fully. Savings to companies due to the decrease in compliance costs, interest expenses and tax disputes cannot be estimated yet. Automation also minimises the tax gap and tax evasion. The Finnish Tax Administration is also investing in software robots (estimated savings equivalent to 1,3 % of total annual costs) blockchain and AI. Similar savings could be achieved in all countries with investments in the automation of taxation. In addition to savings both to companies and member states, automation of taxation would mean an appealing location for businesses to function and grow. The OECD could invest in developing automated and digitalised taxation procedures, which would improve tax certainty.

In order to build data economy, real time economy (RTE) should be enhanced. RTE is about digitalisation of the monetary processes and making them interoperable with all the other digital processes. The monetary data is produced and stored in banking, accounting, brokering, taxation and post-trade services. This data should be made accessible and interoperable. Three key drivers are 1) real time accounting and taxation, 2) digital growth and balance and 3) data economy. The first key driver is being processed in Finland, Nordic and Baltic countries with projects on making financial data collected from various data sources in a structured format, making it possible for the authorities to get real-time information and reports (e.g. financial statements and tax returns) automatically and close to real-time. The real-time financial data is valuable for the company in enhancing business and creating new business models. **Making taxation as easy, effective and accurate as possible enables the company to concentrate on productive business**

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activities, reduces risk of non-compliance. There are projects ongoing, for example two ecosystems: eReceipt and digital company ecosystem. The Nordic countries have started the Nordic Smart Government[2] -project, with a vision that of a data driven Nordic region, where data and digitisation enable value creation by sharing data across the Nordic region in an automatic, secure and intelligent manner, for example to reduce administrative work and to enhance innovation and growth.

The new rules developed under the consensus solution will cause undisputable uncertainty for the companies. This uncertainty will continue at least until there is extensive published tax and court practice that can be referred to. Most probably the initial published guidance from the tax administrations on the rules will not cover all possible interpretation situations that will arise. Considering this, the Finnish Technology Industries find it as essential from a tax certainty point of view that the companies can, in advance, consult with the tax administrations and receive guidance regarding the application of the new rules. **TIF therefore propose that the OECD, in connection with the final set of rules, includes a tool through which companies can receive tax certainty in advance on the new tax rules. The Finnish Technology Industries suggest that example could be taken from the pre-emptive tools used by the Finnish Tax Administration.**

Cross-Border Dialogue

The Finnish Tax Administration uses **Pre-emptive Discussion and Cross-Border Dialogue** as tools to enhance certainty and prevent tax disputes.[3] Companies have found these tools of preliminary guidance of the Tax Administration to be fruitful and effective in increasing the predictability and certainty of taxation and preventing costly tax disputes. The Pre-emptive Discussion process was previously provided only to the large MNEs in Finland (customers of the Large Taxpayers' Office), but because of the positive results, the Tax Administration has expanded the process to be available to all Finnish companies and branches in Finland of foreign companies.

The international version of the Pre-emptive Discussion is the Cross-Border Dialogue (CBD). Under the Cross-Border Dialogue, tax administrations, together with the taxpayer, enter into a bilateral or multilateral dialogue procedure to determine in advance or in real time the tax treatment of a specified international tax issue related to two or more countries. The goal with CBD is to enhance predictability and tax certainty in a timely manner. The CBD is a practical and efficient tool for all the involved tax administrations, under which the tax administrations can - within their own legislative frames - give guidance on the tax treatment of specified cross-border tax issues, collaboratively with the other tax administration and the taxpayer. CBD is intended to be used in concrete and specified tax questions. The outcome of the CBD is a unilateral decision (guidance, advance ruling, unilateral APA or similar) provided separately by each involved tax administration. Under the CBD no agreement is made between the countries. Basically, the tax administrations discuss bilaterally/multilaterally but decide and implement unilaterally.

The CBD process can be used widely in international taxation matters, such as permanent establishment, cross-border losses, withholding taxes and transfer prices. The legal basis of the

[2] In the Nordic Countries, a project called Nordic Smart Government started in 2016. https://nordicsmartgovernment.org/ The aim is to have a digital ecosystem with both privately and publicly owned solutions, where different actors work together to ensure efficient data flow and e.g. to remove the businesses' administrative burdens related to mandatory reporting to the government by automating reporting of financial data, also to be utilised in taxation.

[3] https://www.vero.fi/yritykset-ja-yhteisot/tietoa-yritysverotuksesta/konserniverokeskuksessa_hoidetaan_suome/pre-emptive-discussion-and-cross-border-dialogue/

procedure is exchange of information by the competent authorities (article 26 of the Model Tax Convention) or mutual agreement procedure (MAP, article 25 of the Model Tax Convention). Cross-Border Dialogue has been proposed to the OECD, to be used as an alternative to APA in less complex transfer pricing matters and as a mean of providing tax certainty for non-transfer pricing issues, which currently are outside the scope of APA. Many countries have shown interest in the usage of CBD and the Finnish Tax Administration has concluded already a few CBDs with other countries. **The Finnish Technology Industries supports that CBD (also on a multilateral basis) would be added to the final draft of the OECD proposal,** as an effective tool to prevent tax disputes and to bring tax certainty.

8 VAT

Even though the OECD has stated, that VAT is not to be discussed, but only corporate income tax, **the global taxation system must be considered in its entirety.** Indirect taxes (value added or goods and services taxes) generate significant taxes in the residence country of the customer. Larger markets with more consumers naturally receive a larger share of such indirect taxes. This should be borne in mind when considering proposals which will result in shifting tax revenues away from smaller research and development intensive exporting countries. Also, similar type of problems, as value added taxation has faced over the years, could be triggered, for example related to tracking the location of the customer (also data privacy must be taken into account).

Compliance costs and double taxation could be decreased by using similar reporting and payment tools as EU VAT MOSS, which should be spread to cover countries outside EU, without any value limits. This would also be a sustainable solution as businesses increasingly sell products globally. Also, tax collection via platform providers should be preferred as is done in most countries. VAT collected by platforms treats businesses neutrally regardless of size of business or location of headquarters and should be de facto standard to minimize tax collection expenses.

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