December 14, 2020

Organisation for Economic Cooperation and Development
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Re: Comment Letter on Tax Challenges Arising From Digitalisation—Report on the Pillar One Blueprint

The National Foreign Trade Council (the "NFTC") is pleased to provide written comments on the Tax Challenges Arising from Digitalisation—Report on the Pillar One Blueprint (the "Pillar One Blueprint") released for Public Consultation published October 12, 2020.

The NFTC, organized in 1914, is an association of some 200 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members value the work of the OECD and the Inclusive Framework in establishing and maintaining international tax and transfer pricing norms that provide certainty to enterprises conducting cross-border operations. A list of the companies comprising the NFTC's Board of Directors is attached as an Appendix.

The NFTC appreciates the opportunity to comment on the proposals for further work set out by the Pillar One Blueprint and being discussed by the Inclusive Framework. Given the enormity of the challenge undertaken by the Inclusive Framework – providing a consensus-based long-term solution to the tax challenges arising from the digitalization of the economy by mid-2021 – the NFTC believes that it is critically important to offer a broad range of stakeholders' opportunities for input into the process.

This letter provides more specific comments, with examples when appropriate with respect to each proposal and responds to the specific issues raised by the Pillar One Blueprint. The NFTC will also provide suggestions for additional simplification where appropriate. Given that the political decisions have not been reached on the scope, quantum, tax certainty and administration under Pillar One, we are limited in our response to the technical issues without the resolution of these critical political decisions.

The OECD released an economic impact assessment, "Tax Challenges Arising From Digitalisation—Economic Impact Assessment" on October 12, along with the Pillars One and Two Blueprints. 1 This economic analysis relies on assumptions on the proposed design and parameters of those Blueprints without regard to the final political decisions on Pillars One and Two. It also relies on the potential reaction of MNEs and governments to any of those final decisions. The economic analysis used data that does not take into consideration either the fully implemented Base Erosion and Profit Shifting (BEPS) action items nor does it take into consideration any data following the U.S. implementation of the Tax Cuts and Jobs Act. Without reliable data including the current impact of the implementation of BEPS or U.S. tax reform, it will be hard to determine if there is an economic problem associated with digitalization, or if the problem that the Blueprints are addressing is one of political perception. In prior reports, the OECD has consistently determined that the corporate income tax is the most distortive tax, and that increased corporate taxes fall most heavily on labor and consumers.2The most recent Economic Impact Assessment now reaches a seemingly inconsistent conclusion that an increase in corporate taxes would "support global investment and growth through less quantifiable but nonetheless significant channels which may partially or even fully offset this small negative effect." 3 The Economic Impact Assessment reached the conclusion that an increase in corporate taxes would support growth because, as they noted, corporate income taxes are less distortive than proliferating unilateral measures, including DSTs, retaliatory tariffs and a global trade war. It will be important for member countries to have a credible economic impact assessment to determine the benefit of the Pillar One and Two for their country. Countries then must weigh whether the revenue impact for their country outweighs the cost (i.e. reduction in investment, lower economic growth, administrative costs of implementing the Blueprints, and potential increased disputes with taxpayers and other countries). Accurate economic impact assessments are critical to the long-term success of the OECD digitalization project, and the NFTC welcomes further analysis as the process proceeds.

Amount A:

General Issues

The Pillar One Blueprint significantly expands the scope of this project beyond the original focus on the need for an additional modest allocation of a portion of nonroutine profits to market jurisdictions to correct for a perceived under-allocation due to increased digitalization enabling market exploitation without physical presence. For the project to succeed and be durable, it should be rooted in clearly articulated principles which seem absent from the Pillar One

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1 OECD (2020), *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/0e3cc2d4-en.

2 OECD (2011) *Challenges in Designing Corporate Tax Systems*, OECD Publishing, Paris, p. 14

3 OECD (2020), *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/0e3cc2d4-en, p.11

Blueprint. We are concerned that the Pillar One Blueprint has moved away from its original focus on reallocating a portion of nonroutine returns to market jurisdictions without requiring a physical presence in a simplified manner that reduces complexity and is administrable for taxing authorities and MNEs.

With regard to what types of businesses should be within the scope of Amount A, the NFTC believes the final scope of Amount A should not discriminate against any particular industry or country, should not lead to double taxation, should be focused on remote sales booked outside a market jurisdiction without a physical presence in such jurisdiction, should depend on facts that are easy to identify which are transparent for businesses and tax administrations,—and on which everyone can agree with little difficulty. As the entire economy increasingly becomes digitalized, ring fencing digitalized businesses and consumer facing businesses for special taxes is not a viable long-term solution. Any international tax changes adopted by the G20 and IF should be a durable solution that provides certainty to businesses and governments and will not require continuous international tax rule changes as the economy continues to digitalize.

The NFTC strongly supports rules based on the arm's length principle (ALP) for both Amount A and Amount B. Using a formulary approach based on clearly articulated principles to the Amount A reallocation of a portion of nonroutine returns and the fixed marketing and distribution return consistent with the ALP under Amount B must be clear and administrable. Applying different rules for different industries adds complexity and the potential for double or even triple taxation. Using the ALP has considerable practical and procedural implications. When there is an agreement on the allocation of deemed residual profit, it would be exceedingly untenable if an adjustment by any one or two countries as a result of a transfer pricing audit, MAP or arbitration would affect that multilateral agreement years later. Businesses and countries have been following the OECD transfer pricing guidelines, and the ALP is included in bilateral tax treaties.

The NFTC has the following comments on the proposals included in the Pillar One Blueprint.

Scope Issues

It is difficult to respond with concrete recommendations as the Pillar One Blueprint clearly states that political decisions regarding scope are necessary before deciding on the appropriate technical guidance to determine what activities are in scope. The BEPS Action 1 report said that the digital economy cannot be ring-fenced. The Pillar One Blueprint effectively does ring-fence the current highly digitized business models but also ring-fences consumer-facing businesses. These two sectors of the economy have been singled out under Pillar One for different tax treatment than businesses in other sectors, even though those businesses as well are digitalizing to compete and succeed. The OECD has provided guidance in the past that have become the norm for international taxation. The Model Tax Treaty, the Transfer Pricing Guidelines, and the VAT Guidelines are all used by many governments as guidance as tax laws are being developed or changed. By applying Amount A to two sectors, query whether with the fast technological changes occurring in all sectors of the economy, that ring-fencing automated digital services and consumer-facing businesses will lead to long term stability in the international tax arena, or will it lead to greater uncertainty, double or triple taxation and no end to the number of tax disputes, which is costly for both taxpayers and tax authorities.

NFTC members do not agree among themselves on the scoping issues for Amount A. Some NFTC members believe the original intent of the OECD taxation of the digitalization of the economy project was to address the issue of scale without mass. Consumer facing businesses do not believe they were the original target of Amount A and that they should not be included in Amount A except to the extent that they conduct remote sales without physical presence in the selling jurisdiction. Some NFTC members believe the reasons for including consumer facing businesses in the scope of Amount A are vague and do not match the policy justification for Amount A which is clearly and repeatedly focused on MNEs that do not have a "commensurate presence" in a market. In practice, most consumer facing businesses design, manufacture, market and sell products in essentially the same way that they always have done. A number of countries have made this specific point and have questioned the necessity for the inclusion of consumer facing businesses in scope. Because consumer facing businesses structurally have always had a substantial and taxable presence in markets and are not typically characterized by scale without mass, the rationale for introducing Amount A does not easily apply to them. Other NFTC members note that many large ADS businesses share much in common with CFB businesses, with the need for physical (commensurate) presence in the market and more traditional business models that design, manufacture, produce, market and sell products similarly to CFB. Additionally, many of the rationale for carving out specific sectors (e.g. B2B) would equally apply to consumer facing businesses. Other NFTC members believe that consumer facing businesses belong in Amount A and it is the only assurance that companies from all countries will be subject to Amount A, and since consumer facing businesses sell to consumers and businesses remotely without physical presence in the market jurisdiction, that they should be included in Amount A. These ADS companies also have a substantial presence in markets where they earn the majority of their profits and do not believe this is an argument for CFBs to be excluded from Amount A.

Sector Specific Issues

Some companies in the cloud computing sector do not believe that cloud computing should be included in the definition of automated digital services and that it should not be included on the positive list. This is particularly true for B2B enterprise cloud services that are based on local contracts in on the ground locations where customers are located and where revenues are generated. Enterprise cloud has been singled out by the OECD as essential to helping businesses and governments of all sizes be more efficient. Also, cloud computing services depend upon substantial capital investments by these companies in local markets to build out the in-country computing capacity that customers require and to comply with data protection laws. There may be a misconception that cloud service providers can operate through a "scale without mass" business model, but this is not the case. In fact, the opposite is occurring as these companies continue to expand their local physical presence.

Cloud computing services are a productivity tool and neither satisfy the stated justifications for Amount A nor fit within the criteria for inclusion in Amount A. The need to minimize network latency issues and network capacity demands require significant capital investment in or near the location of customers, limiting the ability of cloud service providers to achieve scale without mass. While cloud service providers do not have to locate data centers in every jurisdiction, no large MNE has a physical presence in every customer jurisdiction, so that should not be a negative distinguishing factor for cloud services. The major cloud services providers do in fact have taxable physical presence in their major markets covering the large majority of their customer revenue.

Some cloud services have minimal brand recognition with users in the market. Cloud services companies (i) do not generally track specifics of user engagement, other than usage of the cloud services, (ii) do not benefit significantly from direct interaction with users and customers or from users' data and content contributions by users, and (iii) do not generally monitor specific user activities or benefit from the resulting data. In addition, concerns regarding competitive advantages for cloud computing overlook the fact that there are no non-digital competitors in this industry space (i.e., the very essence of cloud is its digital nature).

Despite the significant reasons for excluding cloud computing services from the positive list, if they remain in-scope, there is a need for further guidance on "standardized cloud computing services" versus "bespoke cloud services," as there is a view that the degree of cloud service configuration generally depends on a customer's needs and therefore, the determination when the services are "bespoke" will vary by customer. Cloud service installations for major MNE, healthcare, and government customers require significant design, internal legacy IT system integration, and ongoing security and issue identification and management services requiring the attention of highly skilled individuals. Medium-size enterprises likewise have a significant need for pre- and post-implementation support.

Footnote 14 (definition of ADS is different than electronically supplied services in EU VAT law) notes that the proposed definition of ADS would add to taxpayers' compliance burden by creating a new definition that would have to be interpreted independently of the interpretations of definitions of similar concepts in other tax provisions. As noted in paragraph 365, "Cloud computing is unlike other ADS above because it is of most relevance to other businesses".

Some software companies think that the definition of ADS should not include providing software to other businesses (i.e. business to business software transactions.) They believe that software provided to another business is a business input intended to make the business more efficient and productive. It may be considered similar to intermediate products or components that businesses sell to other businesses. Such businesses should not be in scope for Amount A, just as businesses selling such intermediate products or components are out of scope of Amount A. Some NFTC members disagree with excluding cloud services from the ADS definition. As an alternative, further scope limitations could consider business models (even ADS and cloud computing businesses) that are still predominantly landed models, characterized by long sales cycles, with revenues reported at customer location. These business models are currently taxed under existing PE attribution and nexus rules and there should be a clear carve out for such businesses or lines of business even if such companies are deemed to fall within the ADS definition. Other members oppose not carving out cloud computing for the reasons stated above.

The OECD acknowledges that the positive and negative lists included in the scope section of the Pillar One Blueprint, may not be sufficient and offers a default general definition on what constitutes ADS. The Blueprint discussion says that the lists will simplify the determination of in-scope and excepted activities and suggests that individual jurisdictions will be able to make unilateral changes to these lists. This will greatly increase uncertainty, disputes, and the potential for double taxation. It does not make any sense to keep the lists within the framework as they will be outdated and subject to nonconforming adoption.

NFTC members from extractive industries support OECD's decision to exclude from the scope of Amount A non-renewable resources ("extractives") and commodities based on valid policy. NFTC members believe this exclusion should apply to the entire value chain of products commonly derived from extractives that generally are treated as a commodity, such as petrol, diesel, and lubricants (whether un-branded or branded). As mentioned in the Pillar One Blueprint, these products are commodities, and therefore exhibit characteristics that distinguish them from other types of consumer facing products. Petrol, diesel, and lubricants are derived from extractives (principally crude oil and natural gas) through a manufacturing process that is largely standardized across the industry due to governmental regulations and automobile specifications. The un-branded versions of petrol, diesel, and lubricant base stocks produced by dozens of MNEs around the globe are identical; as such, consumers cannot differentiate between products created by one MNE versus another, which means there is no intangible value attributable to any one MNE. Branded petrol, diesel, and lubricants are principally comprised of either un-branded petrol, diesel or lubricants base stocks with only very small molecular differentiations among MNEs. Brand value is small, given the products are essentially commodities. For instance, consumers are more likely to purchase petrol based on convenient location of a service station as opposed to brand. As such, MNEs manufacturing these commodities spend very little on advertising and marketing as compared to other consumer products, simply because there is very little return on this investment given the product is a commodity.

We are unable to agree on the scope issues currently outlined in the Pillar One Blueprint, and it appears that we are in the same position on this as many of the governments involved in the negotiations. The reallocation of taxing rights could be achieved in a more simple, pragmatic, and transparent way.

Amount A Revenue Threshold

NFTC members would like to see a de minimus threshold introduced to reduce the compliance required in nexus jurisdictions where sales are immaterial. If there is no de minimus threshold there will be a significant compliance burden for MNEs with very little benefit to taxing authorities. The two-step test discussed in paragraph 184 of the Pillar One Blueprint seems confusing because it appears that the MNE would only have to proceed to step two if it was not excluded under step one. Additional clarification of this is needed.

Some NFTC companies believe there should be a specific Amount A revenue threshold to exclude large MNEs with a relatively small amount of foreign source in-scope revenue. Some NFTC members believe there should be an exclusion from the application of Amount A for a large MNE with foreign source in-scope revenue that represents a *de minimis* percentage (e.g., 5%) of the large MNE's revenue. Complying with the Amount A rules for MNEs that are in-scope is expected to be a substantial burden, especially for large MNEs that have a small percentage of their business activity that is within the scope of Amount A. An exclusion of large MNEs that have foreign source in-scope revenues representing a low percentage of the MNE's business is an appropriate safeguard to balance the purpose of Pillar One with the expected substantial compliance burden associated with the application of Amount A. To provide additional simplification and ease administrative burden in the case of low-risk groups, some NFTC members suggest that where an MNE group's profits are derived predominantly (e.g. 70% or more) from excluded activities, the group should be excluded from Amount A. Other members argue that setting arbitrary sales or profit thresholds that serve to exclude them from Amount A creates significant horizontal equity issues between similar situated taxpayers while only providing marginal simplification and administrative relief. As a result, both for simplification and to avoid treating similar activities differently under Pillar One, some NFTC members favor the addition of a carveout for MNE groups whose customer base consists predominantly (e.g. 70% or more) of businesses that are carved out of Amount A. Other NFTC members do not support exclusions from Amount A based on a percentage of business activity of a company or whether customers are carved out of Amount A and believe that these types of calculations will create a significant amount of additional complexity and not lead to simplicity. There is concern businesses will have to look through to their customer bases to see whether they might or might not be ADS, and this will be extremely burdensome and create additional disputes for both taxpayers and administrators.

Carve Outs

NFTC members recognize that of the Pillar One Blueprint exempts financial services that several member states have specifically exempted in their DST measures, such as banking, asset management, insurance, and payment services. How the carve-out applies to payment services should be clarified, including the case where stand-alone payment services businesses are not part of an overall banking or lending business. While the regulation applicable to payment services businesses conducted by entities that are not themselves banking institutions is substantial, it may vary from country to country. Furthermore, such regulation continues to change over time as countries address matters of particular relevance within their markets. The recent trend is increased regulation and operational restrictions for payment services. Focusing on the precise contours of regulation applicable to banks, payment services, and e-money runs the risk of different treatment of nearly identical activities depending on the overall makeup of the group and the jurisdiction in which their activities are conducted. Further, a carve-out driven by the specifics of regulation is overly complex and difficult to administer – by virtue of the complexity and divergence of such regulation as well as its constant flow of change. Focusing instead on the nature of the activities performed appears substantially more administrable and is more likely to yield a result that carves-out only those businesses that do not present the policy concerns of Amount A. An activity-focused approach would avoid creating competitive imbalance between payment services providers that are banks and/or governmental or quasi-governmental entities and those that are not.[4] These members therefore recommend making the carve-out applicable to groups undertaking payment services activities.

Nexus Issues

Some NFTC members believe that the "physical presence" plus factor is inconsistent with their initial focus on "remote selling" as the fundamental purpose behind the work on digitalization. Remote sales revenue booked outside a market jurisdiction above an appropriate threshold should be sufficient to be included in Amount A which would be a significant simplification for both tax administrations and MNEs for tax compliance. The "physical presence" remains relevant for the marketing and distribution safe harbor which should apply for all MNEs in-scope for Amount A.

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4 We note that all numerous Digital Services Tax regimes that initially include within scope digital networks specifically carve-out payment services activities. This is because payment services does not present the digital tax concerns that underly the origination of DSTs and Pillar 1

Total in-scope profits in the market jurisdiction should be compared against the safe harbor amount to determine if there is sufficient profit to reduce, and ultimately eliminate, any Amount A allocation. The Pillar One Blueprint often suggests that all in-scope, in-market profits are to be compared against the safe harbor amount, but at times instead suggests that only a portion of the in-scope, in-market profits are to be considered.. All in-scope, in-market profits should be considered, and the safe harbor could be set to approximate a routine return for all activities if necessary.

Some NFTC members believe that there should not be a different nexus standard between CFB and ADS based on the theory that CFBs ability to participate remotely is less pronounced, and the use of third-party distributors creates more complexity for CFBs than ADSs. ADS members believe that ADS business also often sell via third party distributors and often have low profit margins, so this is not a justification for a different nexus threshold. These members argue that setting arbitrary sales or profit thresholds that serve to exclude CFBs from Amount A creates significant horizontal equity issues between similar situated taxpayers while only providing marginal simplification and administrative relief. Some NFTC members disagree with this and believe there should be a different nexus standard for CFB and ADS, based on the use of unrelated third-party distributors. These NFTC members believe that a differentiated threshold between ADS vs. CFB is justified. They note that the economics and pre-tax business needs for consumer facing businesses typically dictate creating a taxable physical presence once the business is large enough to pay for the fully loaded costs of setting up and operating a subsidiary in the market jurisdiction. The proposed blueprint threshold for Amount A for CFB approximates that economic reality. It is also worth noting that Amount A is an excess return concept that should not be applicable where a business is not making an excess return.

Under the Pillar One Blueprint, MNEs will be forced into nexus events by companies (i.e., unrelated distributors) which MNEs have no control over and have no discernable way to determine sales/profits. MNEs cannot control the territories of an unrelated distributor nor can they control the sales value of those unrelated distributors to consumers -- at best, a MNE can only influence and guide. The OECD's assertion that MNEs must renegotiate commercial terms to acquire information on the ultimate destination of products overreaches its authority and may even violate local laws. These requirements place MNEs in a precarious position, forcing them to comply with commercial laws or with tax laws.

To avoid double taxation, the Pillar One Blueprint needs to definitively state that Amount A payments and changes in profit/sales and nexus between countries cannot trigger "exit taxes" under local country tax law. If this is not definitively stated, the profit will be double taxed as year-over-year changes could be misconstrued as exits from countries.

How the new nexus rules are implemented is particularly important for the disposition or acquisition of an asset or business (related or unrelated). Specifically, how will the new nexus need to be treated with regards to disposition/acquisition events? Under the Pillar One Blueprint, will a separate valuation of this "nexus is deemed an intangible" be required in the event of a disposition/acquisition? Further clarification is needed.

Other practical problems are inherent in the Pillar One Blueprint. There is a question about what happens if an MNE discontinues SKUs/product lines as a natural course of business or if an unrelated distributor of an MNE elects to pick up a new product assortment. Will these types of events trigger exit taxation (i.e., unrelated distributor sells into Country A in year 1 & 2 but not in year 3 because of failing consumer demand)? How should these events be managed if they occur part-way during a fiscal year? The Pillar One Blueprint must definitively state whether the Amount A nexus income is capital in nature and creates an intangible. If an intangible is created, it should be capitalized—depreciated and amortized under a standard set of agreed rules. If an intangible is not created, it must be clearly stated that the jurisdiction has no right to any "deemed" intangible when sold.

For jurisdictions where an MNE (1) does not have a deemed presence or tax liability currently but (2) is subject to the new nexus rules, the proposed Pillar One Blueprint approach creates additional complexity. In these nexus jurisdictions, there is no P&L (under global or local GAAP standards) as the MNE does not recognize a full P&L in such locations. As such, these jurisdictions can never be a surrendering jurisdiction -- they can only be a nexus jurisdiction. This lack of symmetry is inconsistent and creates an inherent unfairness.

Revenue Sourcing Rules

The NFTC believes that the multiple simplifying changes to the hierarchy along with elevating the customer billing address indicator to a number 2 position is a positive development. The primary rule for indicators should be consistency with the information MNE's already collect. The recognition in the outline that customers/users can refuse to provide location data should push geolocation lower in the hierarchy. Even where information may be collected for some purpose within an MNE group, extracting and formatting that information for use in tax compliance may present significant operational challenges, which would be compounded to the extent that privacy laws may apply. The hierarchy of indicators should not be designed in a way that would force a taxpayer to use a particular piece of information that may be present somewhere in the MNE group, where, in their reasonable judgment in light of their particular business, the taxpayer concludes that doing so would result in unreasonable costs or a risk of violating legal constraints.

Similarly, while the Pillar One Blueprint in some circumstances requires taxpayers to attempt to obtain information held by third parties (i.e. unrelated distributors), there will in most cases be valid business or legal reasons for third party distributors or customers not to provide that information. We recommend, therefore, that a taxpayer should not be required to incur significant additional costs or modify commercial arrangements in order to obtain information in the possession of a third party.

We suggest that the sourcing indicators should be consistent with VAT indicators where possible. We also think the Pillar One Blueprint must consider the impact and be sure that it doesn't conflict with privacy rules that companies are required to follow (e.g., GDPR). Regarding cloud sourcing rules, cloud service providers should not be required to rely on the information collected by another taxpayer who may or may not have location information and is under no obligation to provide to the cloud service provider. In addition, requiring cloud service providers to collect information on users or customers will exponentially increase the amount of data collected. Mining that data, connecting it with financial data, and trying to ensure the accuracy of data of customers of the cloud service provider's customer would be a monumental task which could also violate business and governmental privacy policies not to mention imposing material costs.

Stock-Based Compensation

In order to effectively attract and retain talent, businesses use a variety of forms of compensation. For many businesses, stock-based compensation is a critical component of designing compensation packages that will allow them to attract talent in the short term and continue to retain that talent in the medium- to long-term. In recognition of that, some NFTC members note that for Pillar Two purposes, as a general matter, stock-based compensation is allowed as a deduction from the GloBE tax base computation to the extent and at the same time it is allowed for local tax purposes. Tax treatment of stock-based compensation is not respected, however, for Pillar One purposes. In their view, this approach has the potential to disadvantage companies that use equity as a component of compensation as compared with companies that use only cash compensation. This could bias companies in favor of cash compensation over stock-based compensation, which in turn could create a bias for debt financing. Increased debt financing would in turn impact earnings per share and, ultimately, market value. These businesses, therefore recommend that the Pillar One tax base reflect treatment in the jurisdiction of the parent entity of the MNE group. Of course, any approach should not create competitive distortions in the market.

Segmentation

Segmentation should be required only in limited cases where necessary to accomplish the objectives of Amount A. For instance, segmentation is appropriate for MNEs with significant revenue outside the scope of Amount A. The general rule should be that MNE's can use their consolidated financial statements. If segmentation is required, it should be based on an MNE's segmentation reported in its public financial statements, unless utilizing financial statement segmentation would be distortive due to significant out-of-scope activities. Likewise, an MNE should be permitted to segment on an alternative basis if more aligned to the objectives of Amount A. Alternatively, while segmentation should not be required, MNEs should be permitted to calculate Amount A on a regionally or geographically segmented basis, at the sole discretion of the MNE and cannot be a requirement imposed by individual jurisdictions on MNEs. In fact, if an MNE has chosen to disclose geographically segmented accounts the same rationale applies as for business line segmentation: it needs to be avoided that low margin segments compensate the need for higher reallocation of high margin segments to the respective markets. Without such segmentation, there is a risk of allocating purely domestic profits away from a jurisdiction. This would be both economically irrational and challenging to justify politically.

Some NFTC members also believe that instances where segmentation is permitted or required, a high-volume of intersegment transactions in isolation should not result in the combination of segments as suggested in paragraph 467. Integrated MNEs generally have significant intersegmental transactions, and such a default rule disallowing segmentation solely due to a high volume of intersegment transactions (as proposed in paragraph 467) could disallow segmentation in instances where a disallowance could be distortive on an Amount A allocation.

Profit Allocation

The NFTC believes that any profit allocation to market jurisdictions under Amount A must be based on clearly defined principles and should be modest. The Amount A solution must include a mechanism to eliminate double counting and double taxation such as a ceiling for markets where an MNE already has a physical presence and additional profits should not be re-allocated to the market if the market is already being compensated at or above the OECD agreed amount. Some members believe there should also be a cap on the amount allocated under Amount A when it is combined with Amount B, and this cap should also be modest. Some members believe the cap should be based on a percentage of system profits. Since Amount B is intended to approximate the ALP, other members believe a simpler approach would be to impose a modest cap on Amount A (less than 2% of local revenue).

Withholding taxes on royalties, interest, technical services, and other IP should be viewed as the market jurisdiction already taxing a share of residual profits. Double counting will arise if the market jurisdictions are allocated Amount A on top of certain existing withholding tax liabilities. The calculated tax on an Amount A allocation should be offset by any withholding taxes already collected by a market jurisdiction(or a market jurisdiction should be obligated to repeal its withholding taxes in order to receive an Amount A allocation).

The Pillar One Blueprint identifies the need for limited book-to-tax adjustments but doing so will result in inconsistent recognition of income. As such, book-to-tax adjustments should be provided only for material items, such as accelerated depreciation. At a minimum, extraordinary or one-time events should be excluded from the Amount A calculation. Furthermore, at the consolidated GAAP level, permanent events that are only recognized for book purposes but not tax purposes should be eliminated from the calculation.

It is anticipated that Amount A will be adopted as a global standard. Without defining a uniform global GAAP standard there will be no consistency in treatment as (even across generally recognized global GAAP metrics) accounting and reporting standards differ. As such, there can be no consistent standard if there are different global GAAP standards being applied. The OECD should use the listed GAAPs and they should have the same level of approval as IFRS (and not be dependent on the equivalency to IFRS).

Clear guidance should be provided regarding the treatment of joint ventures, minority ownerships (especially those that are required by local law). Specifically, such relationships should be expressly removed from the profit before tax calculation.

A clear definition of revenue is a critical component of Amount A and should be provided and aligned within the Pillar One guidance. First, is the revenue for the calculation of Amount A equal to the revenue of MNE to its customer (i.e., unrelated distributor) or the revenue made to final consumers? If "revenue" is the revenue to final consumers, how can this be a reasonable basis if the MNE does not establish nor set the pricing that generates the revenue to final consumer and how is double taxation avoided on the revenue of the distributor?

Revenue is not uniform globally. Specifically, should the revenue value be gross or net (i.e., after adjustment)? How should returns and allowances be treated for the purposes of defining revenue? How should any book-tax differences be managed? Additionally, should the determination of Amount A be based upon the "deemed" net revenue or "actual" net revenue, given that the Pillar One Blueprint is based upon a "deemed" P&L. Inconsistencies in base will create risk of double taxation.

Some NFTC members believe that the Amount A formula should apply to all in-scope business activities in the same way. Digital differentiation mechanisms, including an increased allocation percentage for ADS or a profit escalator introduce unnecessary complexity into the framework and are inherently arbitrary. Increasing the allocation percentage for ADS would further serve to ring-fence those services for more onerous treatment. Including a profit escalator would take the new taxing right to an even greater departure from international tax norms. Rather than a profit escalator, there should be a cap on the percentage of total system profits that would be reallocated on a non-arm's-length basis.

Within the context of profit allocations, a prioritization rule should also be included for surrendering jurisdictions. Specifically, it is likely that any one surrendering jurisdiction will be connected to many nexus jurisdictions. With its finite pool of income, surrendering jurisdictions will need to either selectively surrender Amount A to some nexus jurisdictions and not others or surrender only a portion of the Amount A deemed appropriate for the nexus jurisdiction to all nexus jurisdictions. A prioritization rule is needed. This will be even more particularly important when applying Amount A to a surrendering jurisdiction that is unconnected to a nexus jurisdiction.

Loss Allocation

We believe that the Amount A tax base rules should apply consistently at the level of the MNE group irrespective of whether there are profits or losses.

The carry-forward regime should consider existing or pre-regime losses associated with Amount A activities. Such pre-regime losses were associated with investing in markets and should be recognized as a precursor to any future residual income. The OECD (within the transfer pricing guidelines) recognizes the need for market penetration strategies and such themes should be consistent. The calculation of the pre-regime loss carryforward reducing the Amount A allocation should be consistent with the calculation of Amount A allocation.

As the COVID-19 pandemic continues to have a tremendous impact worldwide, appropriate treatment of losses and profit shortfalls takes on increased importance. In addition to economic losses, some NFTC members believe it is important to apply a carry-over mechanism for what the Pillar One Blueprint refers to as "profit shortfalls." In our view it is a core concept of Amount A that amounts that are subject to reallocation under Amount A include only a modest portion of profits in excess of a threshold that effectively acts as a deemed residual return. For purposes of determining whether an MNE earns such a deemed residual profit, providing a carryover only for economic loss (i.e. the extent by which expenses exceed income) would fail to address the situation in which profits in a previous year may have been greater than zero but less than of a deemed routine return. The calculation of profit-shortfall carryforward reducing the Amount A allocation should be consistent with the calculation of Amount A allocation. Non-Amount A profit-shortfalls should not be able to offset Amount A income.

Consider the following extremely simple example: Suppose that the profit threshold for application of Amount A is set at 10%. MNE Group A earns profits of 10% each year on identical sales revenues. MNE Group B earns 5% in two years and 20% in the third. Over the course of three years, both MNE Groups earn the same total profit. Under an approach that fails to take into account the profit shortfalls in the first two years, however, Group B would be subject to Amount A in the third year, while Group A would not. To address this disparity in treatment, some NFTC members recommend extending the carry-forward regime for losses to include profit shortfalls. In the example above, this would permit Group B to carry forward its profit shortfall of 5% in years 1 and 2 to offset its 20% profit in year 3, which would put it into parity with Group A.

NFTC recommends that all carry-forward loss regimes and profit shortfalls should carry-forward until fully utilized (i.e. indefinite carryforward).

Elimination of Double Taxation in Amount A

The most important consideration in eliminating double taxation in Amount A, is the acceptance and adoption of the rules by all of the members of the Inclusive Framework. If all IF members do not adopt the rules or only adopt some of the rules, there will be no way to control double or even triple taxation as well as the number of tax disputes that will arise. The absence of consensus and conformity will result in a chaotic taxing system that is more complex and harder to administer than anything that exists today. We know from the implementation of country-by-country reports that conformity in execution is not simplistic or straightforward. The complexity of the Pillar One Blueprint approach will only create additional uncertainty, administrative burden on both MNEs and taxing authorities, and controversy. Any one country's non-conformity or staged approach to implementation will degrade the entire approach and the ability to achieve the OECD's goals.

The Pillar One Blueprint moves away from some of the concepts put in place as part of BEPS, including overriding the DEMPE functions (paragraphs 561 and 562). Companies put procedures in place following the final BEPS action report, and to now not recognize those activities as part of the Pillar One Blueprint is counterproductive. Paragraph 582 notes the OECD Transfer Pricing Guidelines identify a series of factors that may entitle an entity to participate in the residual profits generated by an MNE group for transfer pricing purposes that will also be relevant for identifying the paying entities. Paragraph 582 also notes that the activities of the paying entity will likely consist of the performance of some or all of the important functions related to DEMPE of intangible assets of the MNE group that are specific to the MNE group's profits including intangibles related to technology that facilitates market engagement such as technology used in the ADS business to gather user data and content contributions. We believe this language results in the Amount A reallocation overriding the agreement regarding DEMPE in the BEPS project. The IF should prioritize the use of current transfer pricing concepts with additional documentation requirements as necessary for this new purpose. These rules must be simple and binding.

While the Pillar One Blueprint provides mechanisms intended to address double taxation, those mechanisms appear to mitigate double counting only to the extent that a taxpaying entity in a local market is treated as the paying entity with respect to that jurisdiction's Amount A allocation. In other cases, there is a risk that Amount A will result in an increase in taxation in a jurisdiction that may also collect substantial corporate income taxes or other taxes (e.g. withholding taxes or other gross-basis taxes) under existing rules. While the marketing and distribution safe harbor may provide some help with this problem where local marketing and distribution activities are giving rise to double counting, it does not fully address the issue. A more comprehensive measure to eliminate double counting is therefore needed to avoid this outcome by reducing the additional tax imposed under Amount A in a jurisdiction by the amount of income tax or other taxes already paid in that jurisdiction.

NFTC members recommend that an exemption approach to eliminating double taxation be adopted, rather than a foreign tax credit approach.

Amount B

Some NFTC members support the implementation of Amount B as a pilot program. They believe that introducing a new taxing right in Amount A will place enormous strains on MNEs and governments, and that simultaneously implementing a new regime for determining transfer pricing for routine functions is too difficult. In order to enable certainty and reduce controversy associated with this project, other NFTC members would prefer a cap on the attribution of profits to the market where an MNE has an entity in that market and thus would fall under the aegis of Amount B. Such a cap would be based on a fixed percentage of system profits at risk.
Some members point out that benchmarking of routine marketing and distribution activities under the arm's length principle generally produces a narrow range of outcomes as a percentage of sales with limited geography and, greater but still limited, industry differences arising from increased functionality. While Amount B could be implemented based on such a return on sales-based benchmarking approach, we raise the question as to whether, in practice, this will be sustainable given the audit perspectives of many countries. Accordingly, they believe a combined Amount A and B cap-based approach help to reduce such pressures bearing in mind that at certain high levels of system profit the share of profits attributable to marketing and distribution tends to decrease. Other NFTC members believe that since Amount B is intended to approximate the ALP, then a simpler and more appropriate approach would be to include a cap on Amount A (i.e., of 2% or less of revenue).

If the purpose of the Amount B fixed return for marketing and distribution functions consistent with the ALP is certainty and simplification, then Amount B should be sufficiently broad to minimize the likelihood of market jurisdictions asserting more revenue due to additional marketing and distribution-related functions being performed in the market that are not included in the Amount B "routine" scope. The Amount B scope should cover the vast majority of local country affiliates, including limited risk distributors and commissionaires, which would ordinarily be benchmarked using the Transactional Net Margin Method or the Comparable Profits Method. Such a scope would also be important for an effective marketing and distribution safe harbor. If the fixed marketing and distribution returns are based on customer revenue in the market, even if not booked by the local affiliate, then there is no need for quantitative rules for the local affiliate.

Some NFTC members believe that in the Pillar One Blueprint the purpose and effect of the Amount B rules are unclear enough that controversy is inevitable, and they are concerned that a broad scope would merely increase the frequency of that controversy. They are concerned that an immediate implementation based on a broad scope would instead either increase the frequency of controversy, result in a significant number of cases of results deviating significantly from arm's length, or both. In general, arm's-length outcomes require a detailed examination of facts under the comparability standard. In contrast, the Amount B approach, as described in the Blueprint, requires reaching agreement on a generalized basis on arm's length outcomes for a list of specified activities, with variation considered only by industry and geography. A broad scope for Amount B, to include for example limited function marketing and sales support entities, would require substantial variation in the quantum of Amount B, including criteria for choosing among alternative profit level indicators (PLIs), for the variety of fact patterns covered, in order to align with the requirement to produce approximate arm's length results. These members therefore do not support a broad scope for Amount B, at least as an initial matter.

These members believe that it is appropriate instead to start with a narrow scope and high materiality thresholds and evaluate the need or appropriateness of expanding scope only after obtaining experience with how Amount B would operate in practice. They believe this approach would have the additional benefit of taking some time pressure off the need to arrive at standard fixed returns for a broader and more varied scope of activities. Consistent with this view, these members also believe that multifunctional entities should not initially be in scope. This issue could also be revisited after a few years of actual experience with Amount B.

Other NFTC members see Amount B as essential to agreement on Amount A, and at a minimum, any companies subject to Amount A, should be able to rely on Amount B applying to their in-country functions. This means that Amount B should be broad enough (at a minimum) to cover all marketing, distribution, and similar functions in the market country.

The Pillar One Blueprint still leaves gaps for execution. For example, how should significant local/regional/global market events (i.e., hyperinflation, catastrophic events) be considered in the calculation of Amounts A and B? How should significant MNE-specific events (i.e., restructuring costs) be treated?

The Pillar One Blueprint for Amount B is seen by some NFTC members as so confusing that it does not result in the level of administrative ease envisioned. At one point, the Pillar One Blueprint references a distributorship's ownership of assets only to then remark that such activities can be segmented out for separate transfer pricing treatment. Amount B needs to continue to focus on alignment with transfer pricing principles and be commensurate with arm's length principles. For example, quantitative factors should not be included as consistent with existing arm's length standard. The Amount B fixed returns are intended to approximate application of the ALP and should be based upon the functions performed, risks assumed, and assets deployed.

According to KPMG's transfer pricing analysis, sales, marketing and distribution returns consistent with the arm's length standard are low across industries, geographies, and profitability levels for both value-added activities and for limited risk distributors. While low margin businesses necessarily must have reduced distribution returns, contrary to some unsubstantiated assertions, KPMG found that there is a ceiling for returns to sales, marketing and distribution functions, even when an industry segment is highly profitable.3 It will also be important to consider the potential impact of Amount B on low margin businesses. For example, if an MNE has profits below the Amount B fixed marketing and distribution return, it would have no profits left to remunerate its other activities such as manufacturing, etc. This would inevitably lead to double taxation for low margin businesses. As such, the level of profits allocated through Amount B should to some degree consider the system profit of the MNE to avoid such situations from arising. Therefore, we believe the PLI should be determined in accordance with principles under the OECD Transfer Pricing Guidelines.

As we noted earlier, we strongly support the use of the ALP and believe using the current system as much as possible will help to reduce tax disputes.

Tax Certainty and Dispute Resolution

The Amount A and Amount B components of the Pillar One Blueprint greatly increase the potential for tax disputes and double taxation. The multilateral impact of the Amount A profit allocation and new nexus rules, and the new limitations for Amounts B require significant improvements in both dispute avoidance and dispute resolution mechanisms. All participating jurisdictions must agree to be bound by, and to implement, the new Pillar One Blueprint agreed approach which should include binding, highly effective dispute resolution as a minimum standard subject to peer review. Without broad agreement on the circumstances in which such profits can be specially allocated to market jurisdictions, and on the amounts that may be so allocated, double taxation will result.

The Pillar One Blueprint proposed review panel plus a determination panel is complex and requires cohesive international cooperation that is executed on in a prompt and timely fashion. The review and determination panels should be limited to jurisdictions with a direct and material interest in the determination. The absence of prompt and timely conclusions will result in double taxation (even if a MNE proactively seeks agreement upfront) and will leave MNEs with no guidance on what to do if there is a compliance deadline but no timely consensus. A more simplified, straight forward approach should be adopted. A single aggressive country could delay and thwart a review panel and determinations panels which could take significantly longer than referenced in the Pillar One Blueprint. It is important for the MNE's parent company tax administration to agree to the Amount A scope and allocations and for that tax authority to participate in the determination panel under rules that do not allow other countries to override the lead tax authority by majority vote. As noted above, the determination panel should be limited to countries with a direct and material interest in the determination.

The Pillar One Blueprint approach introduces a new "audit cycle" for MNEs in a country (on top of existing audit cycles) by requiring that local tax administrations investigate and agree on filing positions outside of the actual audit cycles of local entities. This will require additional resources and complexity in balancing double taxation and administration.

The Pillar One Blueprint proposed approach for the creation of a shared "data room" does not safeguard taxpayer's information. Information that needs to be shared among taxing authorities should be done directly through the information sharing provisions of tax treaties. The Amount A review and determination panels must be conducted under confidentiality rules and information cannot be used for other purposes.

The panel process is drafted in an anti-taxpayer spirit --the taxpayer is required to suspend the statute of limitations, binding certainty may "fall away" if any member of the MNE group can later pursue domestic remedies with respect to Amount A, or if it is later discovered that information provided by the MNE for purposes of review is inaccurate, incomplete, or misleading (paragraph 731), and affected tax administrations are not restricted from conducting audits or other compliance activities concerning issues that may impact the level of residual profit in a jurisdiction (paragraph 733). These provisions should be modified to better balance the needs of tax administrations and the burden on taxpayers.

Implementation and Administration

At the time of political agreement, countries must agree that relevant unilateral actions should be eliminated and not adopted in the future. These unilateral measures include digital services taxes, equalization levies, diverted profits taxes, the U.K. offshore receipts tax and any similar extraterritorial tax, withholding taxes that could be seen as double counting, including those that might be levied under U.N. Article 12B, and other similar measures. Consideration should be given to a list by country of those specific tax measures that are "relevant unilateral measures" and that should be repealed We recommend that these unilateral actions be withdrawn as part of the Pillar One agreement rather than implementation.

As companies have experienced in implementing the BEPS CbCR requirements, putting systems in place to comply with new rules will take time. The analysis of the systems needed will not be simple, and companies will need a minimum of 12 months lead time to prepare for the changes proposed by the Pillar One Blueprint.

The Pillar One Blueprint is extremely complex and will require time for all countries to implement the provisions. We encourage the IF to be flexible on the implementation of the Pillar One Blueprint and for the OECD to outline a collaborative approach to the implementation of the new tax measures. Such implementation should be accompanied by a firm commitment from the IF to be completed within a designated framework of time to mitigate and minimize nonconformity of the implementation.

Conclusion

The Pillar One Blueprint proposal significantly elevates political concerns and simplification to a level at or above tax policy principles. In our view, a consensus-based and durable rebalancing of taxing rights must have five elements to be successful: (1) any rules providing that a business without a physical presence in a jurisdiction nevertheless has sufficient income tax nexus with that jurisdiction should not discriminate against any industry or country, be clear, measurable and predictable and should avoid creating an expansion of the broader non-tax jurisdictional law principles; (2) any rules for attributing profits (or losses) to a jurisdiction in a manner that deviates from the current post-BEPS Transfer Pricing Guidelines should be specific in scope, clear and administrable in application, and give due regard to value creating activities and investments by the business that take place in other jurisdictions; (3) all participating Inclusive Framework jurisdictions must agree to be bound by, and to implement, the new consensus, and to repeal any related unilateral actions currently in place and for all participants to not adopt additional unilateral measures; (4) the rules must include highly effective dispute prevention and resolution mechanisms as minimum standards subject to peer review; and (5) if businesses already compensate market jurisdictions at or above the IF agreed amount, no additional return should be allocated to such jurisdiction. The third, fourth, and fifth elements are particularly important in the context of this work because any additional allocation of taxing rights to market jurisdictions will often result in an allocation of taxing rights away from other moderate or high-tax jurisdictions.

The NFTC supports the on-going work of the OECD on both Pillar One and Pillar Two, but we believe that any proposal to reach consensus amongst members of the inclusive framework and stabilize the international tax system, should be drafted as narrowly as possible and address the concerns raised in this letter.

Sincerely,

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