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Via email

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Lausanne, 6 March, 2019

Addressing the Tax Challenges of the Digitalisation of the Economy – Comments on the Public Consultation Document

Dear David,

On behalf of the Tax Policy Center of the University of Lausanne (Switzerland), we are pleased to attach herewith our comments relating to the public consultation Document: *Addressing the Tax Challenges of the Digitalisation of the Economy*.

We appreciate the opportunity to provide these comments as the international tax policy issues raised by the digitalisation of the economy represent a core research priority of our institute.

As a matter of principle, we fully support the work of the OECD in this area.

With respect to Pillar 1, we believe that a potential solution should be articulated around four core principles. First of all, any solution should be based on a sound policy rationale. Secondly, such solution should be a neutral and not ring-fenced. Thirdly, the solution should strive to pursue the path of achieving simplicity and legal certainty as opposed to complexity, especially, with respect to profit allocation. Finally, the preferred option should be complemented by an enhanced dispute resolution framework.

At this stage, it seems to us that the marketing intangible proposal would meet the first two of the foregoing criteria. However, with respect to profit allocation we believe that

the option of resorting to pre-determined margins / deemed formulas / fixed percentages should be given further consideration.

With respect to Pillar 2 (Global Anti Base Erosion Proposal), we are of the opinion that the policy rationale for introducing this proposal is unclear at this stage and that the existence of a possible overlap with Pillar 1 has not been sufficiently addressed. Moreover, the Global Anti Base Erosion Proposal, which would entail a significant policy shift as compared to the original scope of the BEPS initiative, seems to be justified by the fact that the changes introduced by BEPS Actions 8-10 as well as BEPS Action 5 are insufficient. We believe that such conclusion should be adequately assessed before introducing new changes to the international tax system. For these reasons, we express a reservation on this proposal due to its unclear rationale and objective.

This being said, our comments on Pillar 1 and Pillar 2 have to be considered as preliminary and would of course need to be refined/revisited once the details of the various policy options are further known.

We would be glad to get the opportunity to attend the public consultation and present our view detailed in this document.

Yours sincerely

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1. Policy assessment of the BEPS Action plan before entering into the digital debate

1.1. Analysis of recommendations based on activity concepts

1. The initial objective of the BEPS project was to ensure that profits are taxed where activities generating the profits take place and value is created. On the other hand, the BEPS Project did not formally aim at revisiting the allocation of taxing rights provided, in particular, by the OECD Model[1]. Likewise, a harmonisation of tax rates was not foreseen[2]. However it was clear that certain activity-based

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[1] This position was clearly expressed by the BEPS Action Plan in 2013: "While actions to address BEPS will restore both source and residence taxation in a number of cases where cross-border income would otherwise go untaxed or would be taxed at very low rates, these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income (OECD Action Plan 2013, p. 12)

[2] See for example the final report on BEPS Action 5 : « *The work on harmful tax practices is not intended to promote the harmonisation of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates. Rather, the work is about reducing the distortionary influence of taxation on the location of mobile financial and service activities, thereby encouraging an environment in which free and fair tax competition can take place. This is essential in moving towards a "level playing* »

concepts needed to be reinforced such as "*control over risks*" and "*DEMPE*" / "*substantial activities*" (nexus approach), the latter being applicable mainly for trade intangibles. The interim report has also highlighted that several MNEs have realigned their tax arrangements with real economic activity to achieve the foregoing.[3]

1.2. Analysis of recommendations made to the PE threshold: BEPS Action 7

2. The provisions recommended by BEPS Action 7 to amend Article 5 have not been implemented widely.[4] Moreover for States that amended the definition, several issues arise with respect to profit allocation to PEs[5]. As a starting point, profit allocation under the separate entity approach or the Authorized OECD approach (AOA), depends on significant people functions, assets employed and risks assumed. This being said, a tension arises between the nexus and profit allocation concepts when the PE does not carry out any activities. This is typically the case when a Non-resident Enterprise (NRE) acts through a related commissionaire (dependant agent or DA) and the activities of the DA trigger a dependent agent PE (DAPE) for the NRE. Arguably, as the DAPE does not carry out any activities by itself (no functions, assets and risks) its remuneration should be nil under the principles laid down by Article 7. However, this position is disputable. In light of the recent guidance issued on profit allocation to such PEs, market jurisdictions may argue for additional profit attribution to DAPEs. Consequently, BEPS Action 7 creates an uncertain profit allocation environment for DAPEs. Moreover, a trend consisting in opting for limited risk distribution models (LRDs) has been observed. The interim report highlighted this strategy and has remarked that several digital businesses, which have operated on a remote basis, have changed their business models and have created the so-called "*resellers*"[6] in the market State.

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[3] OECD, *2018 Interim Report,* Para. 308.

[4] OECD, *2018 Interim Report,* Para. 272.

[5] See thereupon inter alia Robert Danon, Can Tax Treaty Policy Save Us ? The Case of the Digital Economy in: Brian J. Arnold (.dit.), Tax Treaties After the BEPS Project : *a tribute to Jacques Sasseville,* Canadian Tax Foundation, Toronto 2018, p. 75 ss, Vikram Chand/Lisa Spinosa , A Long-Term Solution for Taxing Digitalized Business Models : Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on Shared Taxing Rights Mechanism ? , Intertax 2018, vol. 46, p. 476 ss,

[6] OECD, *2018 Interim Report,* Para. 262.

1.3. High level assessment

3. Against this background, some members of the inclusive framework argue that despite the changes introduced by BEPS actions 8-10 and 5, profit shifting to low tax jurisdictions remains possible. Further, this would also imply that traditional or digital businesses, through a centralized business model, can operate in the market States with low risk distribution models (LRDs) and ensure that only limited returns are allocated to those entities.[7] At the same time, however, it should be be noted that the concepts introduced in the BEPS Action Plan are highly subjective (activity or PE based concepts). It is obvious that if the degree of subjectivity is high in the interpretation process then the chances of the tax outcome being uncertain is also high. Consequently, the chances for tax disputes also increase as well as the risk for double or multiple taxation. This proposition clearly holds true once the structures adopted by taxpayers will become fully transparent to the tax administrations through the Master File (which requires the taxpayer to explain its value chain) and Country-by-Country reporting.

2. Pillar I of the digital debate: Revising profit allocation and nexus rules

2.1. Conceptual basis for taxing cross border business income

4. Currently, cross border business income is taxed in the Country where the productions factors are located. As discussed, the BEPS Project has reinforced the application of this approach by aligning taxation with value creation. As a fundamental starting point, however, a clarification would be welcome as to whether the conceptual basis for sharing the international corporate tax base is to be based on production factors or destination factors (such as the existence of a customer base) or production and destination factors? The report, in the context of the marketing intangible proposal, seems to focus on endogenous factors as opposed to exogenous factors[8] but this needs further consideration as developing markets argue for the latter factors to be taken into consideration.

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[7] OECD, *2019 Public Consultation,* Para. 3.

[8] OECD, *2019 Public Consultation,* Para. 33.

2.2. The User Participation proposal

5. The proposal is premised on the fundamental assumption that in the value creation process of a digital firm *"users"* of a platform create value.[9] Specifically, depending on the digitalized business, active participation of users, by generating content or providing data, creates value. In other words, their contribution leads to network effects and externalities and enhances the brand image and value of the platform.[10] However, this assumption seems to be highly debatable as several arguments can be made that user participation and contribution is a regular business input in the production / processing process.[11] Moreover, the manner in which the proposal is presented, it clearly amounts to ring fencing as it only applies to social media platforms, search engines and intermediation platforms[12]. Furthermore, devising a proposal with a narrow scope makes it less flexible to adapt it to future business models where digitalization may play a key role. As the policy rationale seems to be built on a highly debatable basis[13], a technical assessment of this proposal will not be made hereafter.

6. Similar to the user participation model, short-term measures such as the EU DST are not built on a sound policy rationale. Moreover, these measures could conflict with international obligations (notably in our view with tax treaties[14]) as well as the Constitutional law of certain countries. Therefore, we are of the opinion that such measures should also not be pursued as they can lead to double taxation, distortions and be challenged at a later stage.

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[9] OECD, *2019 Public Consultation,* Para. 18.

[10] HM Treasury, March 2018, *Corporate Tax and Digital Economy,* pp. 7-10; OECD, *2018 Interim Report,* Paras. 37-38.

[11] OECD, *2018 Interim Report,* Para. 39; OECD, *2019 Public Consultation,* Para. 61.

[12] OECD, *2019 Public Consultation,* Para. 19.

[13] See also thereupon Itai Grinberg, User Participation in Value Creation , British Tax Review 2018, p. 407 ss,

[14] See thereupon Robert Danon, Can Tax Treaty Policy Save Us ? The Case of the Digital Economy in: Brian J. Arnold (.dit.), Tax Treaties After the BEPS Project : *a tribute to Jacques Sasseville,* Canadian Tax Foundation, Toronto 2018, p. 75 ss

2.3. Significant Economic Presence (SEP) proposal

7. The SEP proposal is premised on the assumption that digitalization has enabled, to an unprecedented extent, an enterprise to actively intervene in the economic life of another country without having significant physical presence therein.[15] This proposition seems to be a reasonable suggestion from the perspective of the application of the benefit principle. This implies that the State in which the non-resident is actively present through digital means or otherwise is justified to exercise tax jurisdiction.

8. On the other hand, if the policy rationale of the proposal is based on the fact that the production and destination factors should be taken into consideration for taxing cross business income then this would entail a substantial shift in the current framework. Such an approach may also not be in line with the value creation standard.

9. At this point, we are not clear as to whether the SEP proposal follows the former or latter rationale. Even if it follows the former then the State exercising its taxing rights should not argue that all or majority of the profits arising from the presence should be taxable in that State. Taxation should be limited to the benefits that the non-resident taxpayer receives from the State as opposed to general specific local market features available in that State.

10. With respect to scope of the nexus,[16] the proposal seems to apply to an enterprise that exceeds a revenue threshold combined with one or more of the following factors: user based factors (such as the user base or volume of data collected[17]) or digital factors (such as maintaining a website in local language and payment options in local currency[18]). The proposal also refers to "*other factors*" such as responsibility for the final delivery of goods to customers or the provision by the enterprise of other support services and sustained marketing and sales promotion activities.

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[15] OECD, *2019 Public Consultation,* Para. 50.

[16] OECD, *2019 Public Consultation,* Para. 51.

[17] OECD BEPS Action 1 Final Report. Para. 280.

[18] OECD BEPS Action 1 Final Report. Para. 279.

11. Firstly, the scope of the proposal seems to be rather unclear as to whether it applies to *all businesses* or *business that employ digital means* or *only digital enterprises*. If it applies only to *business that employ digital means* or *only digital enterprises*, then this may amount to ring fencing. Secondly, with these "*other factors*", the proposal seems to capture a broader category of businesses either traditional or digital. However, as a discussion on the application of these "*other factors*" has not been made in the BEPS Action 1 report, more guidance on the rationale behind these "*other factors*" would be required.

12. Moreover, special consideration needs to be made to situations where local entities of a MNE can be considered to be key risk bearing entities based on their functional profile. For instance, when Company R in Country R, which operates in the cloud business, sells its services to its related full-fledged distributor, Company S a resident of State S, which then sells those services to clients. Under the current rules, the profit split method could possibly apply to split the profits between Company R and Company S due to their strong functional profiles. In this situation, it should be foreseen that Company R should not be subject to the SEP proposal as substantial profits are being taxed in the hands of Company S.

13. If the SEP nexus is implemented by amending the PE definition, an issue arises as to how does the SEP proposal interact with the fixed place or agency PE concept and their related attribution rules?

14. There may be a possibility that the existing PE concepts may be absorbed by the SEP proposal and hence they may become redundant. On the other hand, it may also be possible that the SEP concept could coexist with the existing PE concepts. In this case, "*rules of order*" should be put into place to resolve the issue of which provision applies first. The co-existence of all these rules could also imply that MNEs may plan and fragment their activities to take advantages of different rules.

15. This proposal requires an in-depth consideration of such issues.

16. A similar issue arises with respect to coordination with profit attribution rules. Some States follow the separate entity and AOA approach to allocate profits to a PE. Under the AOA, it has been argued on several occasions that the existing rules fail to allocate profits to a new nexus such as the SEP. This is

because significant people functions are not performed in the market jurisdiction. However, some other States follow formulary approaches. These States may allocate profits to PE by using formulas based on, for instance, sales. For these States, allocation of profits to a SEP, should not pose a big challenge.

17. This said, we believe that profit attribution rules should be uniformly adopted for the purpose of this proposal. If the attribution rules are non-uniform, the principle of equality and neutrality could be breached.

18. Thus, the greatest difficulty with this proposal pertains to designing uniform profit allocation rules as opposed to nexus rules.

19. To solve the attribution issue, one approach that the proposal contemplates is to adopt a fractional apportionment method.[19] At this stage it is not clear as to whether the proposal is applicable at the level of the MNE Group[20] or at the level of entity, which could trigger a SEP. If the former approach is adopted, the proposal will raise well-known issues that have been heavily debated in the context of the European Common Consolidated Corporate Tax Base. Moreover, as rightly pointed out in the BEPS Action 1 report this approach departs from the current international standards, which are based on the separate entity approach and the arm's length principle.[21] Even if such an approach is foreseen to be applicable at an entity level, it is difficult to foresee that States will agree to uniform weights that have to be allocated to profit allocation factors such as employees, assets or sales. Thus, it would make sense to focus on other approaches as discussed below.

20. An alternate approach, which is discussed, entails resorting to a deemed profit methodology.[22] This method, initially, deems the SEP to be equivalent to a physical presence from which the non-resident enterprise is operating a business. Thereafter, the method determines deemed net income of the SEP by applying a ratio of presumed expenses to the non-resident enterprise's

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19 OECD, *2019 Public Consultation,* Para. 52; OECD BEPS Action 1 Final Report, Para. 287.

20 OECD, *2019 Public Consultation,* Para. 53. The consultation document refers to the "*global profit rate of the MNE Group*". Also, see Para. 56.

21 OECD BEPS Action 1 Final Report, Para. 288.

22 OECD, *2019 Public Consultation,* Para. 54; OECD BEPS Action 1 Final Report, Para. 289.

revenue derived from transactions concluded with customers in the market jurisdiction. The ratio could be determined on the basis of a number of factors, such as by making references to industry profit margins of domestic taxpayers. For example, an online advertiser (non-resident enterprise) could be classified under the advertisement industry and its SEP could be allocated profits on the basis of profit margins derived by comparable advertisement businesses in the market state.[23] This approach, the way it has been presented, seems easy to administer. Also, the approach could seem to fit in the existing framework as it requires a comparability analysis, at least with industry margins. However, as rightly pointed out by the Action 1 report, several issues do arise.[24] Therefore, further analysis need to be carried out as to whether the issues raised in the context of this approach can be resolved.

21. If not, another approach could also be considered in the context of the deemed profit methodology. For instance, the taxable base could be calculated by resorting to two steps. Under the first step, the overall profit to be allocated would be calculated in the proportion of total operating profit of the enterprise multiplied by the ratio between the local turnover and total turnover. Thereafter, in the second step, a pre-determined portion of the amount calculated in Step 1 (for example, 5-20%) will be allocated back to the SEP. Although the profit allocation under this proposal may seem to be modest, this approach seems to be justified in light of the "*benefits*" provided by the market. The benefits being, for instance, providing a legal framework for a non-resident as opposed to the benefit of providing a large consumer base (demand factor). Moreover, under this approach, where the profits allocated to the SEP is more than the overall profit margin of the MNE to which the enterprise belongs (based on its consolidated financial statements) then the profits of the SEP should be adjusted downwards. Such an approach could be used as a proxy to ensure that the SEP is not allocated profits in excess of the operating margins reported by the MNE Group. This approach would be in line with the logic developed in the context of BEPS Action 4 wherein an entity in a MNE can deduct interest in its jurisdiction up to the level of the net interest / EBIDTA ratio of its group. Alternatively, multilateral consensus could be reached by agreeing to common deemed margins that have to be allocated to the SEP.

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[23] OECD BEPS Action 1 Final Report. Para. 290.

[24] OECD BEPS Action 1 Final Report. Para. 291.

22. The SEP proposal contemplates using withholding taxes as a collection or enforcement mechanism[25]. As the withholding tax will be applied in a non-final manner, it will still be necessary to determine the allocation of profits to the SEP. As discussed above, this may not be an easy task. Consequently, as another option, the application of a final withholding tax could be explored as an independent option to reduce complexity.

23. As the proposal may follow an entity approach as opposed to the MNE approach, the relief mechanism under this proposal is straightforward. The country of the taxpayer's residence will provide relief for the taxes paid in the SEP state based on either the exemption or the credit method.

2.4. Marketing intangibles proposal

24. The marketing intangibles proposal is premised on the rationale that an enterprise, traditional or digital (including businesses dependent on user participation), can actively be present in another jurisdiction on a remote basis or through a limited local presence such as a LRD to develop existing or new marketing intangibles such as brands, trade names, customer data, customer lists and customer relationships.[26]

25. This implies that when the non-resident is actively present through digital or traditional means in another jurisdiction it creates marketing intangibles. Due to the footprint created by marketing intangibles the market State is justified to exercise tax jurisdiction. This proposition seems to be a reasonable suggestion and it could comply with the benefit principle. Such an approach, arguably, also seems to be consistent with the value creation standard.[27] Therefore, it could be justified that the profit allocable to marketing intangibles be taxed to a certain extent in the market jurisdiction. As rightly pointed out by the proposal, only the profit allocable to marketing intangibles should be within the scope of this proposal. The profit allocable to trade intangibles should be carved out.[28]

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[25] OECD, *2019 Public Consultation,* Para. 55.

[26] OECD, *2019 Public Consultation,* Paras. 30-31.

[27] OECD, *2019 Public Consultation,* Para. 33.

[28] OECD, *2019 Public Consultation,* Para. 34.

26. In fact, such a proposal could also mitigate profit-shifting concerns to a certain extent. It may well be true that under the post BEPS rules, profit attributable to marketing intangibles can be stripped out of the market State, i.e. the State where they are created. For instance, consider the situation of Company R in Country R (a low tax State), which operates in the business of branded products, sells its products to its related LRD, Company S a resident of State S, which then sells those products to clients. Under the current rules, the LRD is compensated with a routine margin and the residual profits move out of State S. Thus, this proposal seeks to reallocate a part of the residual profits that are attributable to the marketing intangibles to the market State.[29]

27. The question arises as to how does one determine the residual profit allocable to marketing intangible, which could be reallocated to the market State. One approach would be to rely on a facts and circumstances analysis that is the current transfer pricing approach[30]. Under this approach the contribution of marketing intangibles to the overall profits needs to be determined. Thereafter, a portion of the profit linked to marketing intangibles will need to be reallocated to the market State. Clearly, this approach involves a high degree of subjectivity. This could also lead to tax uncertainty and a plethora of tax disputes. An alternate approach to evaluate the contribution of marketing intangibles would rely on costs (capitalized or not) incurred to develop marketing intangibles.[31] Once again, this approach involves a high degree of complexity.

28. Thus, in order to avoid these issues, it would be desirable to foresee the application of a simplified residual profit allocation mechanism[32] that would use mechanical approximations or fixed contribution percentages.[33] The simplified mechanism could be based on deemed margins and formulaic

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29 OECD, *2019 Public Consultation,* Paras. 35-37.

30 OECD, *2019 Public Consultation,* Para. 45 and 46.

31 OECD, *2019 Public Consultation,* Para. 47.

32 For example, see https://mnetax.com/marketing-intangibles-solution-to-digital-tax-dispute-should-apply-only-to-consumer-facing-businesses-us-official-says-32441

33 OECD, *2019 Public Consultation,* Para. 47 and 48.

approaches both at a routine, residual and reallocation level. The reallocation could be based on either sales or in certain cases, users[34]. This would achieve ease of administration[35]. It would be preferable to develop this approach at the level of the MNE as opposed to a business line segmentation as the latter raises significant data availability and administration issues[36].

29. This proposal, the way it has been presented, may not create issues related to ring fencing as it applies across the board to all MNEs.[37] Appropriate nexus rules will need to be developed to implement this proposal. Our suggestion would be to design such rules on the basis of turnover only. This would imply that the additional factors reflected in the SEP proposal would not be reflected in this approach. Moreover, such nexus rules need to be designed independently from the PE framework in order to avoid overlaps with fixed place PE or agency PE rules[38].

30. As the profits that will be allocated to the market are based on a group level determination, the issue arises as to which entity in the group should bear the tax liability and provide for double tax relief[39]. In this regard, it could be foreseen that the relief should be provided by the owner of the intangible or / and the user of the intangible within the Group.

3. Pillar II: Global Anti Base Erosion Proposal (GLOBE)

3.1. Policy rationale

31. In the BEPS Action 1 Report, no recommendation was made with respect to specific measures to address the tax challenges arising from the digitalization of the economy. This position was justified, among other reasons, by the

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[34] OECD, *2019 Public Consultation,* Paras. 73-79.

[35] OECD, *2019 Public Consultation,* Para. 70.

[36] OECD, *2019 Public Consultation,* Para. 71.

[37] OECD, *2019 Public Consultation*, Para. 29.

[38] OECD, *2019 Public Consultation,* Para. 82.

[39] OECD, *2019 Public Consultation,* Para. 83.

perception that several measures developed in the BEPS project would have a large impact businesses benefiting from digitalization.[40]

32. A few years down the line, the BEPS project has reignited the debate on revisiting allocation of taxing rights by contemplating the introduction of specific measures identified in Pillar 1. The work under this pillar would allocate a part of MNEs profit to the respective market jurisdiction.

33. In the most recent development of the debate, some members of the inclusive framework have argued that the activity based measures (see section 1) have not provided a comprehensive solution to address the profit shifting issue.[41]

34. This being said, the policy objective of introducing the GLOBLE proposal is not extremely clear. On the one hand, the way the proposal has been presented, it seems to implicitly tackle the issue of allocation of taxing rights, an issue which is already covered by Pillar 1.

35. On the other hand, the proposal is presented with the objective of preventing harmful race to the bottom of corporate tax rates and the potential proliferation of unilateral counter measures to solve the drop in rates[42]. Also, the proposal looks beyond genuine productive activities carried out in a jurisdiction by focussing on rates applicable in that jurisdiction.[43] As indicated earlier, this would represent a major policy shift[44].

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[40] OECD BEPS Action 1 Final Report. p 13

[41] OECD, *2019 Public Consultation,* Para. 89.

[42] OECD, *2019 Public Consultation,* Para. 90.

[43] OECD, *2019 Public Consultation,* Para. 91.

[44] Compare for example with the final report on BEPS Action 5 : « *The work on harmful tax practices is not intended to promote the harmonisation of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates. Rather, the work is about reducing the distortionary influence of taxation on the location of mobile financial and service activities, thereby encouraging an environment in which free and fair tax competition can take place. This is essential in moving towards a "level playing* »

36. The proposal argues that it respects the sovereignty of States but at the same time also argues that when a State does not enforce its sovereignty then other States can go beyond their own taxing jurisdiction and exercise taxing's rights on genuine business activities carried out in the former State[45]. While this proposition is per se open to debate, the proposal directly interferes with the sovereignty of States to set its own tax rates as well as certain policy choices in the way they see fit. The merits and demerits of this approach should be deeply considered.

3.2. Scope of the rules and related compatibility issues

37. At the outset the question arises with respect to carve outs from the regime. The question is whether substance-based activities, in general, should be carved out or substance based activities that are availing themselves of preferential regimes that have been approved by the Forum on Harmful Tax Competition[46]. With respect to the latter, the issue arises irrespective of whether these activities are carried out in a low tax or a high tax country as the income derived in these regimes will be subject to nil / minimal taxation.

38. If the objective is to counter race to the bottom then arguably substance is not relevant as the focus would be on effective tax rates. However, such rules will undermine the work carried out by the BEPS Project in the context of BEPS Actions 8-10, Actions 5 and Action 6.

39. We understand that the US GILTI regime[47] only looks at effective tax rates as opposed to substance in the offshore entity. While the US approach seems be coherent on policy grounds it clearly undermines the work carried out by the BEPS Project.

40. On the other hand, the German royalty limitation rule, which applies to payments subject to low effective taxation, has a carve out for royalties paid

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[45] OECD, *2019 Public Consultation,* Para. 90.

[46] OECD, *2019 Public Consultation,* Para. 95 and 105.

[47] See further on this, OECD, *Interim Report* 2018, Para. 285. For a detailed analysis, see D. Shaviro, *The New Non-Territorial U.S. International Tax System, Part 2*, *Tax Notes*, July 9 2018, 171.

to a nexus compliant IP box regime.[48] The German approach seems to be "*partly balanced*" between Action 5 and low effective tax rate considerations.

41. In our opinion, if a GLOBE type proposal would have to be devised, it should be premised on sound policy grounds. Thus, it should either be premised on the US approach which looks only at effective tax rates or should rely on a "*comprehensive*" substance carve out. The "*comprehensive*" substance carve out approach would ideally be more suitable as opposed to an approach that undermines the work carried out by the BEPS Project.

42. That is, a "*comprehensive*" approach would carve out all substance-based activities irrespective of whether or not they are compliant with BEPS Action 5. This would imply that the GLOBE will be hollowed out and will only be applicable in artificial situations. Such an approach would also comply with the proportionality principle to counter tax avoidance within the EU internal market which is currently based on the wholly artificial arrangement threshold[49].

43. A partly balanced approach i.e. an approach which carves out BEPS Action 5 situations whereas BEPS Actions 8-10 situations are not carved out, is incoherent from a policy perspective and could arguably amount to a non-neutral measures.

44. Moreover, several issues arise with such an approach. Inbound or outbound rules, as described in the proposal, could conflict with treaty provisions. However, such conflicts could be avoided by designing specific rules in treaties that would authorize the application of such rules. On the other hand, implementing such inbound and outbound rules in conformity with EU law would not necessarily be an easy task.[50]

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[48] See further, B. Heidecke, R. Holst, *An Assessment of the Draft Rule Limiting the Deduction of Royalties*, International Transfer Pricing Journal, May/June 2017, 216.

[49] For a comparable discussion in the framework of ATAD I and CFC rules, see for example Robert Danon, Some Observations on the Carve-Out Clause of Article 7(2)(a) of the ATAD with Regard to Third Countries in Pistone P., Weber D. (eds.) *The Implementation of Anti-BEPS Rules in the EU : A Comprehensive Study* chap. 17, IBFD, 2018; Robert Danon, La règle sur les sociétés contrôlées de la directive européenne anti-évasion fiscale : analyse critique et impact pour la Suisse in *IFF Forum für Steuerrecht*, 2016 (4) pp. 286-319.

[50] OECD, *2019 Public Consultation,* Para. 98.

45. Therefore, we express a strong reservation for the GLOBE type proposal.

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