To Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA
From KPMG International

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Ref KPMG Response to the Public Consultation Document titled Pillar One – Amount A: Draft Multinational Convention Provisions on Digital Services Taxes and other Relevant Similar Measures

Thank you for the opportunity to comment on the Public Consultation Document titled *Pillar One – Amount A: Draft Multinational Convention Provisions on Digital Services Taxes and other Relevant Similar Measures*.

A core objective of the OECD's BEPS 2.0 initiative is to restabilize the international tax system. The removal of digital services taxes ("DSTs") and other relevant similar measures is critical to these efforts, and to avoiding international trade disputes, which the OECD has previously estimated could reduce global GDP by more than 1%.[1]

The agreement reached by over 135 members of the Inclusive Framework in October 2021, included a clear commitment to remove and not introduce all DSTs and other relevant similar measures with respect to all companies.[2] We are concerned that as drafted Articles 37 and 38 are insufficient to deliver on this clear commitment.

Article 37 – Removal of Existing Measures

We recognize that including a list of existing DSTs and relevant similar measures that jurisdictions will be required to remove following the entry into effect of the Amount A Multilateral Convention ("MLC") is a pragmatic way to identify such existing measures.

Once the Inclusive Framework has developed this list of measures, we would encourage them to seek input from relevant businesses to ensure that the list identifies all existing DSTs and relevant similar measures.

We are concerned by the proposal in FN2 that existing measures could continue to apply to groups with an Ultimate Parent Entity ("UPE") located in a jurisdiction that is not Party to the MLC. This could result in scenarios where a group is subject to an existing measure (such as a DST) and is also subject to and pays tax under Amount A, if the profits that are subject to reallocation under Amount A are realized and taxed in a jurisdiction other than the jurisdiction where the UPE is resident. It could also result in Amount A continuing to

[1] OECD (2020), *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*.
[2] OECD (2021), *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*.

apply to groups that would not be in-scope of Amount A, solely because of where their UPE is located. For this reason, we encourage the Inclusive Framework to reject this proposal.

Article 38 – Provision Eliminating Amount A Allocations for Parties Imposing DSTs and Relevant Similar Measures

As drafted, we have three concerns with Article 38. First, the proposed definition of "digital services tax or relevant similar measure" is ambiguous and could be read not to extend to even existing DSTs, which the Inclusive Framework has been clear should be removed following the implementation of Amount A. Second, it is unclear how the process to identify such measures is intended to operate. Third, the enforcement mechanism (i.e., denying a jurisdiction taxing rights over Amount A) is weak and should be strengthened.

Definition of digital services taxes or relevant similar measures

The provision defines DSTs or relevant similar measures uses a cumulative criteria that looks to include in-scope measures that are:

a) determined primarily by reference to the location of customers or users, or other similar market-based criteria;

b) applicable by its terms to non-residents, foreign-owned businesses or in practice exclusively or almost exclusively applicable to non-residents or foreign-owned businesses; and

c) placed outside the income tax system (and therefore outside the scope of tax treaty obligations).

We are concerned that disputes are likely to arise about whether, for example, a revenue threshold results in a measure applying "almost exclusively to foreign owned businesses". We note that it is clear that a number of existing DSTs are narrowly targeted at a select group of large digital businesses, which contribute the vast majority of the revenue such measures raise. For example, a recent report by the UK National Audit Office stated that 90% of the revenue raised by the UK DST was paid by five businesses. However, we are concerned that it could be argued that in many cases DSTs do apply to domestic groups and hence fall outside the scope of this criterion.

We are also concerned by the emphasis placed on whether or not a measure is treated as an income tax or placed outside the scope of tax treaty obligations. This could allow jurisdictions to retain measures such as significant economic presence ("SEP") rules that are targeted at digital businesses, provided that such rules are limited by treaties.

We note that the European Commission is considering putting forward a proposal for a specific digital levy without prejudice to the ongoing negotiations at the OECD over Pillar One. We encourage the Inclusive Framework to consider whether or not such a digital levy would be consistent with the terms of Article 38 to limit the risk of future disputes.

The definition of digital service tax or relevant similar measure specifically excludes "artificial structuring to avoid traditional permanent establishment or similar domestic law nexus requirements that are based on physical presence". We are concerned that this could be used by jurisdictions to sidestep this provision and so consider that this exclusion should either be removed or substantially tightened.

Process to identify such measures

The Public Consultation Document proposes that a Conference of the Parties would determine whether or not a measure introduced by a jurisdiction was a digital services tax or relevant similar measure. We note that it is not clear whether a jurisdiction that introduces a new tax measure could opine on whether or not such measure was a digital service tax or relevant similar measure. The Conference of the Parties process would be ineffective if a jurisdiction had an effective veto over whether a measure it has introduced was covered by the MLC.

Even beyond this, we are concerned that the process for identifying such measures could be frustrated by a group of jurisdictions. For this reason, we think there would be merit in exploring other approaches for determining whether a given measure falls within the definition set out in Article 38.

Enforcement mechanism

We are concerned that the penalties imposed on jurisdictions that adopt digital services tax or relevant similar measure, i.e., denying them the ability to tax Amount A, will have limited affect. This approach risks legitimizing jurisdictions that decide to adopt a DST as an alternative to Amount A, if they consider this to be in their fiscal interest.

We are particularly concerned by the suggestion in FN4 that jurisdictions should only be denied an allocation of Amount A that is proportional to the revenue raised by an offending measure or that has de minimis impact, as this risks further reducing the impact of the proposed enforcement mechanism.

We encourage the Inclusive Framework to consider what other enforcement measures could be used in situations where a jurisdiction adopts a digital service tax or relevant similar measure, including whether there could be a specified list of sanctions that jurisdictions could apply bilaterally.

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