HEARING ON OECD PILLAR 1: ENSURING THE BIDEN ADMINISTRATION PUTS AMERICANS FIRST

HEARING

BEFORE THE

SUBCOMMITTEE ON TAX

OF THE

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United States House Committee on
Ways & Means
CHAIRMAN JASON SMITH

FOR IMMEDIATE RELEASE CONTACT: 202-225-3625
February 29, 2024
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Chairman Smith and Tax Subcommittee Chairman Kelly Announce Subcommittee Hearing on OECD Pillar 1: Ensuring the Biden Administration Puts Americans First

House Committee on Ways and Means Chairman Jason Smith (MO-08) and Tax Subcommittee Chairman Mike Kelly (PA-16) announced today that the Subcommittee on Tax will hold a hearing to consider the Biden Administration's negotiations on OECD Pillar 1 and related public input by stakeholders and experts. The hearing will take place on **Thursday, March 7, 2024, at 2:00 PM in 1100 Longworth House Office Building**.

Members of the public may view the hearing via live webcast available at https://waysandmeans.house.gov. The webcast will not be available until the hearing starts.

In view of the limited time available to hear the witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record can do so here: WMSubmission@mail.house.gov.

Please ATTACH your submission as a Microsoft Word document in compliance with the formatting requirements listed below, **by the close of business on Thursday, March 21, 2024**. For questions, or if you encounter technical problems, please call (202) 225-3625.

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The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission but reserves the right to format it according to guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed but will be maintained in the Committee files for review and use by the Committee.

All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Please indicate the title of the hearing as the subject line in your submission. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

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The Committee seeks to make its facilities accessible to persons with disabilities. If you require accommodations, please call 202-225-3625 or request via email to WMSubmission@mail.house.gov in advance of the event (four business days' notice is requested). Questions regarding accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the Committee website at http://www.waysandmeans.house.gov/.

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OECD PILLAR 1: ENSURING THE BIDEN ADMINISTRATION PUTS AMERICANS FIRST

THURSDAY, MARCH 7, 2024

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TAX,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The subcommittee met, pursuant to call, at 2:50 p.m., in Room 1100, Longworth House Office Building, Hon. Mike Kelly [chairman of the subcommittee] presiding.

Chairman KELLY. So we just finished a voting series, and I think that more of our folks will be here.

I want to thank you all for being here today. This is incredibly important, some of the things we get a chance to talk about, and the issue today, to me, is incredible. I think this is one of the most complicated issues that has come up.

And, while I try to avoid that when I am back home, people will still ask me to do it, and I say, listen, I live in a world of acronyms. I have no idea—neither do you—as to what is going on, but we will try to address at least the start of it today on a global tax situation that makes no sense to me for America.

So I want to thank you all for being here today. We will be talking about OECD's Pillar 1 negotiations. And I am looking forward to the opportunity from my colleagues on both sides of the aisle and myself to hear our witnesses' testimony and perspective on OECD Pillar 1 and what the Biden administration's negotiations mean for America.

So just clearly starting off—and I asked Elise who put all this together who—she serves with me in our office—if you could put some glossary together so we can look at all these acronyms and give us some kind of an idea of what it is that we are talking about, and it is almost impossible to do. But the Organisation for Economic Co-operation and Development is the OECD.

The Biden administration is negotiating a bad business deal for America where U.S. companies and taxpayers will foot the bill. This Pillar 1 deal negotiated at the Organisation for Economic Cooperation and Development and was originally intended to eliminate the digital service tax to create a fair playing field globally, but, in reality, their proposal will not equalize the playing field. This tax burden will fall disproportionately on American companies, which are nearly half of the largest and most profitable in the world.

I brought several things today that are just props, and if we can—do we have the one?

So this is Atlas with the whole world on his back. And instead of Atlas, let's imagine this as America. And, somehow, we are saddled with the idea that, if it is to be, it is up to us, and we must be the participants at an unusual level in order to make some of these things work.

I am sorry. I was born in America. My business is all America. Everything I have done is America. And, if it hadn't been for America, there would probably be not the world that exists today because of World War I and World War II, and we continue down a road which is really scary.

The Biden Treasury Department has worked with OECD and foreign governments to cramp this Pillar 1 proposal instead of with the legislative body which represents the Americans that will have to pay for this deal. And, in my eyes, the worst part of this negotiation is Treasury's complete lack of cooperation with Congress on OECD Pillar 1.

The Biden administration leapfrogged Congress and put the interest of foreign governments ahead of the concerns of the men and women elected to represent Americans' taxpayers. We will do our due diligence to protect American companies and consumers and ensure they get a good deal.

Let's state the facts here. Two-thirds majority is required in the Senate for enactment of Pillar 1. In today's political environment, it is hard to believe that we can get that much support even on naming a post office, let alone an international tax treaty. It is simply not feasible without taking into consideration frequent and significant input from Congress.

The aspect I find most ironic, Pillar 1 falls apart without the United States' invested interest. Literally, the proposal written by OECD requires the United States to be involved in the final deal. But why, they ask. Without America's taxing rights under a—Pillar 1 collapses. That tells me everything I need to know.

And, if we can, we will give Atlas a break. I just want you to look at the number of countries that are involved with this, and it would be an interesting exercise for somebody to take a look at this and understand, where is America? Who props up—there are 145 different countries. I mean, I am trying to look at some of these and, quite frankly—and not that I am uneducated, but I have no idea who these countries are, where they are located, and more critically, why is it involved in any kind of a tax policy that we are trying to develop?

So thank you.

Now, the Biden administration needs to be transparent with Congress on strategy on Pillar 1. Congress has requested revenue estimates from the Biden administration. They have failed to follow through on this request.

Previously, Secretary Yellen acknowledged that, if enacted, Pillar 1 would reduce U.S. revenues. Through Treasury's public comment period, U.S. businesses pointed to significant flaws with Pillar 1. Now, I am concerned that the Biden Treasury is putting the interest of foreign governments before U.S. businesses and the American economy. Just this week in The Wall Street Journal, it was noted, the benefit to America still hasn't appeared from the OECD deal that Treasury and Secretary Yellen just signed the United States up for. So we still don't know, how does that help us.

But the facts are simple. Through Pillar 1 negotiation, U.S. companies would bear far more than our fair share out of the 145 countries involved. And, confirmed this week by JCT estimates, more specifically, if Pillar 1 would have been in place in 2021, the U.S. would have lost $1.4 billion in tax revenues.

At the end of the day, folks, this is about the U.S. economy's security. Is the Biden administration going to sacrifice the financial success of U.S. businesses in our economy for international accounting bureaucrats' approval or for Europe to benefit from our economic success?

We are not going to stand by idly and watch the Biden administration and Treasury Department sacrifice American tax dollars for political gain, and I believe we will find out today that my colleagues feel exactly the same way. This deal diminishes the economic security of the United States at a time of global instability, and we just cannot take that risk.

I look forward to hearing from our panel of witnesses to discuss with this subcommittee their expertise when it comes to OECD and international tax, and I really appreciate their outlook on Pillar 1.

So now I would like to recognize my friend from California, Mr. Thompson, for his opening statement.

Mr. THOMPSON. Chairman Kelly, thank you very much for holding today's hearing. And thank you to all the witnesses for being here today.

Today's hearing is about a topic of great importance. It is a very technical and weedy topic, but that is exactly what this subcommittee is for: doing a deep dive on some of the thorniest tax topics facing our Nation.

The proliferation of digital service taxes over the past 5 years is concerning to members on both sides of the aisle. These taxes, as imposed, discriminate against some of the most innovative American-built businesses and act as a quick and politically convenient revenue grab for the governments who impose them.

Pillar 1 of the OECD's Inclusive Framework is the world's attempt to agree to roll back these discriminatory taxes by creating a novel framework to reallocate a share of the most profitable companies' profits to the jurisdictions where their customers live.

The human resources that have been put into devising this brand-new international tax frame are astounding. The Biden administration and other delegates at the OECD should be commended for their tireless dedication to the task. Their goal is an admirable one: providing stability to the international tax system.

With a stable tax system, everyone wins. Business wins when it knows what its tax bill will be when it seeks to invest in foreign markets. Governments win when they know they can rely on a stable revenue stream to fund their operations. And everyone wins when we avoid costly and protracted transfer pricing disputes, which wastes both government and private resources.

Any multilateral negotiation such as this one discussed here is bound to be a tough one. No doubt, members will be discussing the JCT's report that was released to accompany this hearing showing that the flow of funds between the United States and other jurisdictions will generally be negative for the U.S. We are, in JCT's estimation, going to be losing $1.4 billion each year under the Pillar 1 agreement.

For some, that might be the end of the discussion. Why give up revenue to other countries, they will ask. My view is that we need to understand the benefits of the agreement and not just look at the cost. What are the benefits of the international stability the agreement could potentially provide? For instance, Amount B, if other countries will accede to the Biden administration's "red line" to make Amount B mandatory, could present a real benefit for U.S. businesses by significantly reducing transfer pricing disputes.

And, perhaps more important, those who look at the JCT report and say that we should pack our bags and go home should ask themselves, what is the alternative? Are advocates for abandoning Pillar 1 then suggesting that the patchwork of DST that will doubtlessly spring into place are preferable to the Pillar 1 proposal? And, if not, how do you believe that the United States can stave off those taxes?

To be clear, I am not arguing that the administration should sign just any agreement. A final Pillar 1 deal must provide protection against unilateral DST and promote a high level of tax certainty and stability without conceding on key U.S. interests.

That being said, the questions I have raised are serious ones that must be addressed if one advocates abandoning the OECD process, and the very nature of those questions is why I remain supportive of the administration staying at the table and devoting themselves to this crucially important endeavor. As they say, if you are not at the table, you are on the menu.

And, Mr. Chairman, before I yield back, I would just like to ask that if we do this again, I would hope that we would invite the Treasury Department who is representing us at the OECD matter. If you recall, we had them before when we discussed this, and I found them to be very helpful.

Again, Mr. Chairman, thank you. Thank you, witnesses. And I yield back.

Chairman KELLY. Thank you. And Mrs. Yellen will be here very quickly at the beginning of April, so we will have a chance to talk to her about that.

I would like now to introduce the panel. Let me tell you—thank you all for being here. You give up a day of your life to come here. Now, clocks and calendars don't seem to matter in this business. We had it scheduled for 2 o'clock, but then we were asked to go and vote, which is kind of really why we were elected. So I want to thank you for coming here today to discuss with us what I find to be a very complicated issue.

But Megan Funkhouser is with us today, and she is the senior director of Policy, Tax, and Trade at the Information Technology Industry Council. Rick Minor is senior vice president and international tax counsel at the United States Council for International Business. Thank you.

Gary Sprague is partner at Baker & McKenzie. Daniel Bunn is president and CEO of the Tax Foundation.

Thank you all for joining us today. Your written statements will be part of today's hearing, and you each have 5 minutes to deliver your oral remarks.

Ms. Funkhouser, please.

STATEMENT OF MEGAN FUNKHOUSER, SENIOR DIRECTOR OF POLICY, TAX AND TRADE, INFORMATION TECHNOLOGY INDUSTRY COUNCIL

Ms. FUNKHOUSER. Chairman Kelly, Ranking Member Thompson, and members of the Tax Subcommittee, thank you for the opportunity to testify today.

My name is Megan Funkhouser, and I lead international tax policy for the Information Technology Industry Council, also known as ITI. In this role, I represent the global technology industry's perspectives before policymakers in the United States and abroad, including on the efforts in the OECD/G20 Inclusive Framework that are the subject of today's hearing.

ITI's membership comprises leading companies from all corners of the technology sector, including hardware, software, digital services, semiconductor, platform, network equipment, cloud, cybersecurity, and other internet- and technology-enabled companies that drive innovation and rely on technologies to evolve their businesses.

ITI's membership includes many of the largest U.S. corporate taxpayers and top investors in research and development, contributing to U.S. competitiveness and the strength of the U.S. economy. That is why we greatly appreciate this committee's leadership in advancing the pro-growth tax package that passed the House earlier this year.

Thank you for convening today's hearing to discuss updating international tax rules through Pillar 1. ITI greatly appreciates members' interest in and engagement with the Inclusive Framework's efforts, from participating in meetings in Paris and Berlin, to encouraging the Treasury Department to hold a consultation on the draft Multilateral Convention to implement Amount A of Pillar 1, as well as sending many congressional letters and statements, particularly those expressing strong bipartisan opposition to digital services taxes.

Absent robust U.S. engagement, including that of Congress, there is little chance of resolving outstanding issues with Pillar 1 and crafting a final package that provides certainty and predictability for taxpayers. That is why I am glad the committee is holding this hearing today.

All of ITI's member companies rely on clear and established tax rules to innovate and grow their operations. However, the proliferation of digital services taxes has contributed to the fragmentation of the international tax system by departing from long-standing international tax norms such as neutrality, efficiency, certainty, and simplicity.

The first generation of digital services taxes targeted globally engaged companies that provide services like digital advertising and digital intermediary services. Subsequent iterations expanded to capturing nearly all nonresident companies engaging with the market. We have also seen governments adopt novel approaches to introduce extraterritorial means of corporate taxation, which contribute to uncertainty and instability for taxpayers.

Congress' consistent bipartisan opposition to digital services taxes and other novel approaches has undoubtedly helped to stem the further proliferation of these damaging measures, as have the Office of the U.S. Trade Representative's Section 301 investigations.

Ultimately, global tax policy challenges require global tax policy solutions, which is why ITI supports reaching a multilateral consensus-based solution that withdraws digital services taxes and prevents their future introduction.

In light of alternatives, ITI sees potential in the draft Multilateral Convention for developing a multilateral consensus-based framework to alleviate the negative consequences of the increasingly fragmented and controversy-heavy international tax environment.

I would like to request to submit ITI's response to Treasury's consultation for the record, but want to highlight here three buckets: one, relieving double taxation; two, securing the removal of digital services taxes and relevant similar measures; and three, ensuring tax certainty.

First, ITI firmly believes that income should be taxed once, with concerns of the extent of relief in some circumstances where a company is already paying taxes on residual profits in a jurisdiction, as well as the menu of options and limited commitments that governments have to fully relieve double taxation.

Two, on the removal of digital services taxes, ITI recommends strengthening the definition of prohibited measures to reduce subjectivity, as well as introduce an enforcement mechanism to give greater weight to the political commitment to withdraw a digital services tax or relevant similar measure.

Third, and finally, the approach under consideration in Pillar 1 would represent a significant overhaul of international tax rules. Providing certainty, particularly advanced certainty, for taxpayers and tax administrations alike as they adapt to new rules will be critical for supporting an environment that fosters investment and innovation.

Taking a step back to consider the bigger picture, ITI also supports extending the standstill on the imposition of newly enacted digital services taxes, discouraging the Canadian Government from advancing its digital services tax proposal, securing a robust Amount B, and confirming the treatment of Pillar 1 taxation for the purposes of Pillar 2.

Again, absent robust U.S. engagement, including that of Congress, there is little chance of resolving these outstanding issues and crafting a final package that provides certainty and predictability for taxpayers.

Thank you, again, for the invitation to testify. I look forward to answering your questions.

[The statement of Ms. Funkhouser follows:]

Written Testimony of

Megan Funkhouser
Senior Director of Policy, Tax and Trade
Information Technology Industry Council (ITI)

Before the
Subcommittee on Tax
Committee on Ways and Means
U.S. House of Representatives

OECD Pillar 1: Ensuring the Biden Administration Puts Americans First

March 7, 2024

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Chairman Kelly, Ranking Member Thompson, and members of the Tax Subcommittee, thank you for the opportunity to testify today.

My name is Megan Funkhouser and I lead international tax policy for the Information Technology Industry Council (ITI).[1] In this role, I engage with policymakers in the United States and abroad to advance ITI member priorities in the international tax policy space, including the efforts in the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework (IF) that are the subject of today's hearing.

ITI represents 80 of the leading information and communications technology (ICT) companies worldwide, serving as the ICT industry's premier advocate and thought leader in the United States and around the globe. ITI's membership comprises leading innovative companies from all corners of the technology sector, including hardware, software, digital services, semiconductor, network equipment, cloud, cybersecurity and other internet and technology-enabled companies that rely on ICT to evolve their businesses. ITI's membership includes many of the largest U.S. corporate taxpayers and top investors in research and development, contributing to U.S. competitiveness and the strength of the U.S. economy.[2]

ITI greatly appreciates Congress's interest in and engagement with the IF's efforts, including through today's hearing, your Committee's participation in meetings in Paris and Berlin, encouraging the U.S. Treasury Department to hold a consultation on the draft Multilateral Convention to Implement Amount A of Pillar One (MLC), and many congressional letters and statements, particularly the strong, bipartisan opposition to digital services taxes (DSTs). **Absent robust U.S. engagement, including that of Congress, there is little chance of resolving outstanding issues and crafting a final package that provides certainty and predictability for the global technology industry.** That is why today's hearing is an important opportunity, and ITI looks forward to continuing the conversation.

ITI's Engagement with the OECD/G20 Inclusive Framework

Where the international tax system has traditionally based taxation on where companies have a physical presence, digitalization can enable value creation and engagement of users far beyond that physical presence. This has led to Pillar One negotiations in the IF to update the longstanding norms that anchor the international tax system to better reflect the digitalization of the economy and bring greater taxing rights to market jurisdictions. Simultaneously, a number of governments adopted DSTs and other problematic unilateral

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[1] The Information Technology Industry Council (ITI) is the premier global advocate for technology, representing the world's most innovative companies. Founded in 1916, ITI is an international trade association with a team of professionals on four continents. We promote public policies and industry standards that advance competition and innovation worldwide. Our diverse membership and expert staff provide policymakers the broadest perspective and thought leadership from technology, hardware, software, services, and related industries. Visit https://www.itic.org/ to learn more.

[2] Marty Sullivan, "Which Corporations Pay The Most Federal Income Tax?" *Tax Notes* (and Forbes), November 3, 2023, https://www.forbes.com/sites/taxnotes/2023/11/03/which-corporations-pay-the-most-federal-income-tax/?sh=52b792103c61.

tax measures that attempt to ring-fence the digital economy for taxation purposes and contravene international tax and trade norms in similar ways: applying to gross revenues instead of net profits; multiple revenue thresholds and other stipulations that target largely non-resident, globally-engaged companies; and a narrow scope of covered digital activities that largely excludes domestic competitors from liability. The proliferation of DSTs and other problematic unilateral tax measures poses a growing threat to the competitiveness of U.S. companies, and the unilateral measures currently in effect have real material impacts on their operations.

ITI views the IF as the best-positioned venue to address the tax challenges arising from the digitalization of the global economy, and ITI and its members are committed to supporting the IF's efforts to establish a multilateral, consensus-based, and principles-based solution to those challenges. Over the years, ITI has contributed to the IF's work by developing consultation responses to negotiators' questions and proposals, participating in public meetings, and publishing principles to guide negotiators as they undertake significant reforms to the international tax system.[3] The release of the draft MLC in October 2023 marked the first time that taxpayers and other stakeholders could review the draft package in its entirety; the global technology industry applauds Congress for encouraging the U.S. Department of the Treasury to hold a public consultation on the draft package.

Putting Pillar One into Context

The OECD has been hosting discussions for comprehensive international tax reform for more than a decade. Beginning in 2013 at the direction of the G20 and with input from OECD members, the OECD's Base Erosion and Profit Shifting (BEPS) project identified a set of actions with the intent of eliminating double taxation and double non-taxation, improving tax transparency, and improving dispute resolution, among other goals. While participating jurisdictions produced many outcomes that were endorsed by G20 Leaders in November 2015 (some of which are reflected in the 2017 Tax Cuts and Jobs Act), they decided to establish a longer timeline to address Action 1: Tax Challenges Arising from Digitalisation, and the G20 directed the OECD to invite non-G20 jurisdictions to join in implementing the BEPS outcomes and contributing to discussions in what is now the IF.

In 2017, the IF restarted its work to address the tax challenges arising from the digitalization of the global economy, now known as the Two-Pillar Approach. Pillar One, the topic of today's hearing, comprises several components: Amount A, which reallocates new taxing rights for certain residual profits to market jurisdictions; Amount B, which intends to simplify transfer pricing rules for companies and tax authorities, particularly in low-capacity countries; mechanisms to eliminate double taxation and provide for dispute prevention and

[3] Notable ITI engagement includes the December 2023 response to the U.S. Treasury consultation on the draft MLC to Implement Amount A of Pillar One, the August 2023 comment on the IF's Amount B public consultation document, the January 2023 comment on the IF's draft provisions on digital services taxes and other relevant similar measures, the August 2022 comment on the IF's Progress Report on Amount A, the September 2022 presentation at the IF's public consultation meeting on the Progress Report on Amount A, and the May 2020 publication of ITI's principles for the IF's Two-Pillar discussions.

resolution; and the removal of DSTs and relevant similar measures (RSMs). In October 2023, the IF released the draft MLC, the Explanatory Statement to the MLC, and the Understanding on the Application of Certainty for Amount A of Pillar One as well as a statement committing to the release of final MLC text by the end of March 2024.

In light of alternatives, ITI sees potential in the draft MLC for developing a multilateral, consensus-based framework to alleviate the negative consequences of the increasingly fragmented and controversy-heavy international tax environment.

ITI put forward the following Pillar One-related priorities and objectives as key feedback to the U.S. Treasury Department's consultation to guide the Department's engagement in the IF and contribute to its future consideration of a MLC:

- **Improve and complete the draft MLC.** ITI draws particular attention to achieving better balance between administrability and precision in the revenue sourcing rules, providing more double taxation relief through the marketing and distribution profits safe harbor (MDSH), clarifying that a measure can be a DST or RSM if the scoping and/or burden of collections primarily falls on non-resident taxpayers, making clear that significant economic presence (SEP) measures are not appropriate for any taxpayer, and strengthening Contracting Parties' commitment with respect to subnational taxes. ITI encourages the IF to further consider an enforcement mechanism to ensure the standstill and rollback of DSTs and RSMs occurs. We also note with concern the outstanding issues in the MDSH section, as these issues have significant bearing on the overall effectiveness of Amount A.

- **Extend the standstill on the imposition of newly enacted DSTs and RSMs.** ITI strongly supports extending the standstill on the imposition of DSTs and RSMs, as it provides for a more stable tax environment in the interim and reduces the risk of perverse incentives that may derail finalization of the project. The U.S. Treasury Department should continue pushing for the IF to provide an explicit extension of the standstill through the earlier of December 31, 2025 (to provide sufficient time for the IF to achieve consensus on all material aspects of the MLC) or the coming into force of the MLC. While the October 2021 Statement's standstill expired on December 31, 2024, the December 2023 Statement noted that the IF's ongoing work included consideration of the standstill.[4]

- **Dissuade the Canadian government from adopting a DST.** Despite significant milestones in the IF, the Canadian government continues to reiterate its interest in advancing a DST. ITI continues to call on Congress, the U.S. Treasury Department, and U.S. interagency partners to encourage the Canadian government to fully drop its

[4] "Update to Pillar One timeline by the OECD/G20 Inclusive Framework on BEPS," December 18, 2023, https://www.oecd.org/tax/beps/update-pillar-one-timeline-beps-inclusive-framework-december-2023.pdf.

consideration of a DST and respect its commitment to realizing a multilateral, consensus-based solution through the IF.

- **Finalize Amount B and commit to expanding initial scoping.** ITI continues to appreciate the U.S. emphasis on the need for a robust Amount B to fulfill the Pillar One package. Amount B has a critical role to play in securing tax certainty and facilitating a more predictable and stable international tax landscape. Since the U.S. Treasury Department consultation, the IF released the Report on Amount B, which outlines a "simplified and streamlined approach" for applying the arm's length principle to in-country baseline marketing and distribution activities. While the IF's release of the report on Amount B is a start, ITI seeks a commitment from the U.S. Treasury Department to develop an explicit roadmap for expanding Amount B's coverage, particularly for services and intangible goods and services, and providing for a more consistent adoption across jurisdictions.

- **Confirm the treatment of Pillar One taxation for the purposes of Pillar Two.** The Commentary to the Global Anti-Base Erosion (GloBE) Model Rules supports the application of Amount A before the GloBE Rules and the alignment of market jurisdiction tax with related GloBE Income but also foreshadows the development of further administrative guidance to address the treatment of Pillar One taxation.[5] The U.S. Treasury Department should work with the IF to prioritize developing administrative guidance to make clear the treatment of Pillar One taxation for the purposes of Pillar Two.

Suggestions to Improve the draft Multilateral Convention for Amount A of Pillar One

Continued, robust U.S. engagement can help make the difference in improving the MLC and securing a more certain and predictable international tax environment. Evidence of improvements from past drafts includes making sourcing rules more administrable, expanding matters in scope of dispute resolution, and tightening language around criteria to identify DSTs and RSMs. While ITI's comment letter to the U.S. Treasury Department has been submitted for the record, below are key recommendations related to preventing double taxation, identifying and providing for the withdrawal of DSTs and RSMs, and providing for tax certainty.

Preventing double taxation

The MDSH is meant to prevent double counting by adjusting downward a government's allocation under Amount A for the other ways in which a government may already be taxing a company's residual profits. A robust MDSH is critically important to a successful Amount A and should account for withholding taxes in a

[5] GloBE Model Rules Commentary on Article 4.2 at paragraph 29: "Tax on net income of a Constituent Entity under Pillar One would be treated as a Covered Tax under the GloBE Rules as a tax with respect to income or profits. Because Pillar One applies before the GloBE Rules, any income tax with respect to Pillar One adjustments will be taken into account by the Constituent Entity that takes into account the income associated with such Tax for purposes of calculating its GloBE Income or Loss."

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meaningful way. However, the number of unresolved issues related to withholding taxes is concerning given the importance of double taxation relief and the overall effectiveness of Amount A.

As drafted, there is a considerable gap between the initiation of nexus for Amount A allocations (EUR 1 million (approximately USD 1.08 million) or EUR 250,000 (approximately USD 271, 000) for certain jurisdictions) and the application of MDSH (EUR 50 million or approximately USD 54.3 million), which limits the effectiveness of the MDSH as it will not be available in many jurisdictions and in-scope taxpayers will bear a significant compliance burden. ITI suggests the IF remove the thresholds altogether for application of the MDSH or, at a minimum, establish the same threshold for receiving an Amount A allocation and benefitting from MDSH.

In a similar vein, the global technology industry continues to view the "jurisdictional offset percentage" in Article 5(d) as undermining the guiding principles behind the MDSH. The jurisdictional offset percentage reduces a taxpayer's MDSH by different percentages based on ratios considering payroll and depreciation. Instead, ITI recommends that the jurisdictional offset percentage be eliminated or set at 100% in all cases, and that Amount A should be adjusted for 100% of the withholding tax paid in a jurisdiction.

The draft MLC allows for significant flexibility in domestic laws that may yield double taxation. First, governments can choose to provide relief through the exemption method or the credit method. Industry has consistently called for the exemption method as the only means of eliminating double taxation and maintains that position with regard to the MLC. Second, if the IF continues to allow for the credit method, then there should be strong guardrails to ensure that double taxation relief is actually realized in a reasonable amount of time. For example, the rules establish a minimum of three years for credit carryforwards but do not articulate what happens if the relief is not achieved in three fiscal years. ITI recommends making credit carryforwards indefinite until the relief is achieved. Finally, the IF should make clear that jurisdictions cannot deny other double tax relief as a result of relief being granted under the MLC.

Identifying and providing for the withdrawal of DSTs and RSMs
ITI strongly welcomes the removal of existing DSTs and RSMs for all companies and the development of criteria to prohibit the future imposition of such measures. To increase the effectiveness of this outcome, ITI recommends clarifying that a measure can be a DST or RSM if the scoping and/or burden of collections primarily falls on non-resident taxpayers. Similarly, the standard in Article 39.2(b)(ii)(B) of "[having] the effect of insulating domestic businesses from the application" and the accompanying statement that the evaluation of the measure will take into account the "policy objectives of the tax," introduces more subjectivity into the evaluation of a measure and could enable the continued introduction of discriminatory measures

under the guise of other "policy objectives." ITI suggests removing the relevant criteria prong altogether or establishing guardrails to ensure that consideration of "policy objectives" does not become a carte blanche.

The success of Pillar One depends in large part on the complete withdrawal of DSTs and RSMs, yet the draft MLC does not include an enforcement mechanism for the standstill and rollback of DSTs and RSMs. The carrot for withdrawing a DST is receiving Amount A taxing rights; however, there is no stick that recognizes the harmful effects of DSTs to the overall international tax and trade environment and encourages jurisdictions to roll back their DSTs. While the Preamble to the draft MLC emphasizes the "shared commitment not to adopt new DSTs or RSMs as of the beginning of the application of the new taxing right," an enforcement mechanism for the standstill and rollback of DSTs and RSMs would give greater weight to the political commitment.[6]

Promoting tax certainty
The approach under consideration in Pillar One would represent a significant overhaul of international tax rules. Providing certainty – particularly advance certainty – for taxpayers and tax administrations alike as they adapt to new rules will be critical to supporting an environment that fosters investment and innovation. The draft MLC proposes a Tax Certainty Framework for Amount A (e.g., whether a taxpayer is in scope, advance certainty with regard to aspects of a taxpayer's internal control framework, etc.) and Tax Certainty for Issues Related to Amount A (e.g., issues covered under an income tax treaty that may have bearing on elimination of double taxation with respect to Amount A).

The MLC does not directly address tax certainty for issues related to Amount A in the absence of a covered tax agreement. While the United States has negotiated and ratified income tax treaties with nearly 70 trading partners, companies in the United States are engaging with even more jurisdictions around the world. To achieve greater stability for issues related to Amount A, ITI encourages the IF to adopt language in the MLC that directs covered jurisdictions and in-scope taxpayers to follow transfer pricing guidelines (e.g., the OECD Transfer Pricing Guidelines) if a covered tax agreement is not in effect. This will be especially important for taxpayers that will not benefit from the limited scope of Amount B as currently drafted.

The Growing Challenge of DSTs and Other Unilateral Tax Measures
I want to take this opportunity to underscore why the global technology industry supports reaching a multilateral, consensus-based solution that withdraws DSTs and RSMs and prevents their future introduction. **All of ITI's member companies rely on clear and established tax rules to innovate and grow their operations.** However, DSTs depart from

[6] Multilateral Convention to Implement Amount A of Pillar One at page 6, https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.pdf.

long-standing international tax principles that bring predictability and stability to the international tax system, such as "neutrality, efficiency, certainty and simplicity, effectiveness and fairness, as well as flexibility."[7] Even if a company is not in scope today, all U.S. companies should oppose the targeting of U.S. or non-resident companies for unprincipled tax treatment, as the scope and rates of these measures could continue to expand and put further pressure on the international tax and trade system. As noted in the September 2023 U.S. House of Representatives Ways and Means Committee letter on the Canada DST, "there is a broad international consensus that unilateral DSTs are counterproductive."[8]

Congress's consistent, bipartisan opposition to DSTs and other novel approaches has undoubtedly helped to stem further proliferation of these damaging measures, as have the Office of the U.S. Trade Representative's (USTR) Section 301 investigations.[9] The Section 301 reports into measures adopted by Austria, France, India, Italy, Spain, Turkey, and the United Kingdom found the measures to discriminate against U.S. companies, be inconsistent with prevailing principles of international taxation, and burden or restrict U.S. commerce. For example, applying a tax on gross revenues is impactful on all companies because it does not take into account the costs of operating the business (i.e., payroll, research and development, intermediary inputs, etc.), but especially penalizes low-margin and loss-making companies.

The expanding scope of subsequent measures underscores the urgency to address the proliferation on behalf of all companies. While the first measures may have targeted a handful of companies, more recent iterations expanded to capture nearly all non-resident companies engaging with a market, including micro, small, and medium-sized enterprises (MSMEs). For example, India's twice-expanded Equalisation Levy applies to non-resident companies that have gross revenues in excess of INR 100,000 (approximately USD 1,217.80), and Kenya's DST applies to all non-resident companies – regardless of size or revenue – that offer services through a digital marketplace. **The breadth, scoping, and rates will undoubtedly continue to expand in the absence of meaningful resolution, to the detriment of U.S. commerce and innovation.**

Canada's Digital Services Tax Act

The proposed Canada DST is a live threat that poses real tax and trade policy challenges as well as undermines the ongoing negotiations in the IF.[10] I want to note ITI's thanks to the

[7] "Addressing the Tax Challenges of the Digital Economy," OECD/G20 Base Erosion and Profit Shifting Project, September 16, 2014, at page 30, https://www.oecd.org/ctp/addressing-the-tax-challenges-of-the-digital-economy-9789264218789-en.htm.

[8] https://lahood.house.gov/_cache/files/1/a/1a36ff72-343a-46fd-bc5e-79ab8e705f4a/94DD96E406ED86FBCB374C0941349F74.canada-dst-letter---final.pdf

[9] ITI's December 2023 response to the U.S. Treasury consultation provides an appendix of relevant taxes.

[10] For more information about the Canadian DST proposal, please see the comments ITI submitted in response to Finance Canada's latest consultation on the DST proposal: https://www.itic.org/policy/2023.09.08ITIonCanadaDraftDigitalServicesTaxAct_final%5B97%5D%5B38%5D.pdf.

many U.S. House of Representatives Ways & Means Committee members who joined the bipartisan September 2023 letter to U.S. Trade Representative Katherine Tai and Secretary of the Treasury Janet Yellen expressing serious concern about the proposed Canada DST.[11] ITI strongly encourages Congress to maintain the pressure on the Canadian government, particularly as the Canadian parliament is actively considering the legislation. Last week during a parliamentary hearing, a Canadian government official reaffirmed interest in applying the DST retroactively to January 1, 2022.[12] If Canada moves forward, we could see a potential resurgence of novel taxes targeted at U.S. and/or non-resident companies. The more governments that adopt unilateral tax measures, the greater the opportunity for perverse incentives to derail the finalization of a multilateral outcome that would bring much-needed certainty, stability, and predictability to the international tax system.

The Bigger Picture: Uncertainty in the International Tax System Beyond DSTs

DSTs are not the only extraterritorial or distortive measures that companies are facing around the world. Governments have been pursuing novel approaches to introduce extraterritorial means of corporate taxation, despite the clear tax and trade implications. For example, Germany's Section 49 imposes a withholding tax on the registration of intellectual property (IP), the Australian Taxation Office's draft taxation ruling TR 2024/D1 would significantly deviate from international tax norms around the characterization of software payments by distributors and resellers, and several jurisdictions (Colombia, India, Pakistan, etc.) have adopted SEP or digital permanent establishment measures that eschew the longstanding definition of permanent establishment. The structures and rates of the taxes may differ, but they share a common denominator of yielding unprincipled, double or multiple taxation at the expense of companies investing in the United States. We may see these types of approaches gain more traction absent strong U.S. engagement on individual measures and in multilateral, consensus-based discussions in the IF.

The introduction of novel approaches to tax policy has been accompanied by increased controversy in the form of disputes and aggressive audit practices, which undermine certainty and predictability for companies as well as strain resources. This is why making a meaningful Amount B is so important for taxpayers and tax administrations alike. The Report on Amount B released in February 2024 represents a start but ultimately the U.S. and other IF members should work expeditiously to expand the scope of Amount B to cover services (including digital services) and digital goods, which constitute an increasingly significant aspect of the global economy, and provide a more consistent adoption of the simplified and streamlined approach. As of now, governments can choose whether to adopt one of two approaches or decline to adopt Amount B altogether, and an "outcome determined under the simplified and streamlined approach by a jurisdiction is non-binding on the counter-party

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11 https://lahood.house.gov/_cache/files/1/a/1a36ff72-343a-46fd-bc5e-79ab8e705f4a/94DD96E406ED86FBCB374C0941349F74.canada-dst-letter---final.pdf

12 Amanda Athanasiou, "Canadian Official Defends DST Against U.S. Backlash," *Tax Notes*, March 1, 2024, https://www.taxnotes.com/tax-notes-today-international/tax-reform/canadian-official-defends-dst-against-u.s-backlash/2024/03/01/7j8c1

jurisdiction."[13] Amount B should be mandatory for jurisdictions to adopt, given that would increase the certainty that the simplified and streamlined approach intends to bring to the system.

Protecting U.S. International Tax Policy Measures Abroad

ITI supports a U.S. tax system that fuels growth and a global tax system that provides much-needed certainty for companies to innovate, expand operations, and provide goods and services to individuals and companies worldwide. This Committee's tax work is incredibly important for promoting U.S. competitiveness, and we applaud your leadership in advancing the *Tax Relief for American Families and Workers Act of 2024*. Such efforts strengthen continued U.S. technology leadership.

Another important component of supporting the competitiveness of companies that invest in the United States is protecting U.S. tax rules abroad. For example, ITI appreciates that the U.S. Treasury Department has committed to defending the Foreign-Derived Intangible Income (FDII) regime in international forums such as the Forum on Harmful Tax Practices. FDII has successfully promoted U.S.-based IP ownership and will become increasingly important to ensuring a robust U.S. tax base. Congress should encourage the U.S. Treasury Department to continue standing up for U.S. tax policy in bilateral relationships and multilateral forums.

Conclusion

Members of the Committee, ITI and our member companies welcome your attention and contributions to the Inclusive Framework's negotiations and the perspectives of the stakeholder community. As the approaches under consideration would significantly change the rules that have grounded the international tax system since the League of Nations, it is critical to take time for analysis and thoughtful and informed conversation. Ultimately, global tax policy challenges require global tax policy solutions.

I thank the Chairman, Ranking Member, and Members of the Subcommittee for inviting me to testify today and for their interest in and examination of this important issue. I look forward to your questions.

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[13] "Pillar One – Amount B" at page 15: https://read.oecd-ilibrary.org/taxation/pillar-one-amount-b_21ea168b-en#page1

Chairman KELLY. Thank you, Ms. Funkhouser.

Mr. Minor, you are recognized.

STATEMENT OF RICK MINOR, SENIOR VP, INTERNATIONAL TAX COUNSEL, UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

Mr. MINOR. Good afternoon, Subcommittee Chairman Kelly, Ranking Subcommittee Member Thompson, and other members of the Subcommittee on Tax. Thank you for the invitation to testify at this hearing on Pillar 1.

My name is Rick Minor. I am the international tax counsel for the U.S. Council for International Business.

Pillar 1 is the attempt to change the international tax system to reallocate taxation rights to the market jurisdictions and eliminate the discriminatory network of digital service taxes and other similar measures. Such measures threaten to expand globally, jurisdiction by jurisdiction, and further destabilize the international tax system.

The Multilateral Convention provides a legal framework and detailed rules for the implementation of the so-called Amount A taxing right and the removal of DSTs. Amount A is a novel regime that applies on top of the existing U.S. international tax rules for in-scope U.S. multinationals. Amount B is a simplified set of rules outside the MLC for the common pricing of routine, cross-border distribution services.

USCIB makes four recommendations in reference to Pillar 1. Number one, the elimination of double taxation is a high priority for U.S. multinationals. Let me repeat that. The elimination of double taxation is a high priority for U.S. multinationals. A Pillar 1 solution that does not effectively eliminate double taxation in its application is not sustainable over the long run.

USCIB members remain concerned that the draft MLC does not adequately deliver on the objective to avoid double taxation. This should be a key priority for governments and the U.S. business community when considering Pillar 1.

Number two, the definition of DSTs and other relevant similar measures in the draft MLC must be revised. The prevention and rollback of DSTs must be comprehensive or the MLC will fail to stabilize the international tax system.

One of the critical objectives of the Pillar 1 project is to remove harmful tax measures that target U.S. companies. These taxes are becoming more common, and the MLC should ensure that DSTs and other measures are withdrawn and not enacted in the future.

The MLC should not enable countries to make a choice between Amount A and DSTs. The message from the U.S. should be that discrimination against U.S. companies should not be permitted in any case. Fiscal measures specifically targeted at U.S. multinationals should never be a legitimate tax policy in a stable international tax system.

We note our disappointment that Canada has not respected the DST standstill agreement that was recently extended. Their continued insistence on moving forward with their DST puts at risk the principles of the broader project of Pillar 1.

Number three, the scope of Amount B needs to be expanded. Progress could be achieved now with the creation of a robust and explicit roadmap of future design features, including the extension of Amount B to retail sales as well as to sales of digital goods and services.

Amount B is an important component of Pillar 1 given the potential for it to deliver significant tax administration efficiencies. Tax controversies regarding routine distribution structures are time-consuming for tax administrations and taxpayers alike. All involved could benefit from the use of pricing safe harbors that are broadly respected across jurisdictions.

We are concerned that the current design of Amount B falls short of the stated objectives of the OECD in its original blueprint. The OECD and Inclusive Framework must continue their efforts to negotiate and ultimately agree upon an Amount B design that is acceptable to all stakeholders and adopt it globally.

Number four, USCIB encourages the Biden administration and U.S. Congress to remain engaged in the OECD process. The common mission is to ensure a comprehensive and durable multilateral solution to these complex international challenges now and going forward.

Since the Pillar 1 solution was proposed, USCIB has offered practical solutions to advance the design of its components. Although we have not had a seat at the table in these years-long Inclusive Framework government negotiations, we can imagine a reality in which these rules can exist in some form if the final rules stabilize the international tax system.

We are available for any further requests for discussion on these topics beyond this hearing. Thank you for your attention.

[The statement of Mr. Minor follows:]

United States Council for International Business

Written Testimony of Rick Minor

The House Committee on Ways and Means

Subcommittee on Tax

Hearing on

Ensuring the Biden Administration Puts Americans First

March 7, 2024

Chairman Kelly, Ranking Member Thompson, and members of the Subcommittee on Tax. Thank you for the opportunity to testify at this hearing on the components of the Organisation for Economic Co-operation and Development/Inclusive Framework (OECD/IF) Pillar One project (Pillar One). I am the Senior Vice President and International Tax Counsel for the U.S. Council for International Business (USCIB).

USCIB is a multi-disciplinary policy association founded in 1945, with offices in New York and Washington, DC. Our member base includes over 100 of some of the largest multinational companies from every sector of the U.S. economy and professional advisory firms. The USCIB tax committee currently consists of over 500 tax experts from our member companies and firms.

Significantly, USCIB is the U.S. affiliate to Business at the OECD (BIAC), the business advisory group to the OECD, which includes a multinational tax committee on which I and other USCIB members serve. BIAC allows USCIB an additional formal platform to represent our companies' views before the OECD and to engage directly with our tax counterparts at the business association affiliates from other OECD member states.

USCIB is also the U.S. affiliate of the International Chamber of Commerce (ICC). The ICC is the only business organization which has observer status at the United Nations General Assembly.

We are a consensus-based organization, and this is reflected in our formal consultation letters and in my comments today.

We recognize the importance of the multilateral work performed at the OECD and strive to improve the outcomes of that work by sharing the perspective of U.S. business. Given our role as the voice of U.S. business at BIAC and before the OECD, USCIB has submitted its own comment letter to every OECD Pillar One design consultation request in the last three years. On December 5, 2023, we also filed our consultation letter in response to the U.S. Treasury request for public input on the draft Pillar One Multilateral Convention ("MLC"). The MLC provides the legal framework and detailed rules for the implementation of the so-called Amount A and the removal of Digital Services Taxes (DSTs) and relevant similar measures. This statement relates to our positions in that letter and intervening developments, including the release of the February 19,

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2024, version of the so-called Amount B, a simplified set of rules for pricing for tax purposes certain cross-border distribution activities.

Pillar One Observations and Recommendations

Throughout the consultation process, USCIB has emphasized its concern that the formula-based design of Amount A, as well as deficiencies with the revenue sourcing methodology and the Marketing and Distribution Safe Harbor ("MDSH"), will lead to unexpected results.

USCIB has also made the following principal recommendations:

1. **Reduce double taxation**. A solution that does not effectively eliminate double taxation is not sustainable over the long run and therefore should be a key priority for governments and the U.S. business community.
2. **Revise the definition of DSTs and other relevant and similar measures in the current draft of the MLC**. The prevention and rollback of DSTs and similar measures must be comprehensive or the MLC will have failed to stabilize the international tax system.
3. **Expand the scope of Amount B.** The scope of Amount B needs to be expanded and progress could be achieved now with the creation of a robust and explicit roadmap of future design features, including the extension of Amount B to retail sales as well as sales of digital goods and services.
4. **Stay with the multilateral process**. We encourage the Biden administration and U.S. Congress to remain engaged in the OECD process to ensure a comprehensive and durable solution to these complex international challenges now and going forward.

Amount A Background

Following the OECD's Base Erosion and Profit-Shifting (BEPS) work, many countries argued that the so-called digitalization of the economy was not properly allocating taxes among countries because companies could have significant economic activities in a country with little traditional investment in that country. This was referred to as 'scale without mass.' Scale refers to the consumer base in the country and mass to a taxable presence in that country under the traditional norms of international taxation.

These traditional norms are embedded in our tax treaty network and national laws. They require a company to establish a physical presence in a country to be subject to its taxation. The existing norms generally source profits to the location of where services are performed or where property is held (the 'source' jurisdiction), rather than where a service might be received or consumed (the 'market' jurisdiction). European countries moved unilaterally to tax companies considered to be commercially accessing their 'market' without making changes to the overall framework of the rules. These DSTs fell outside of the scope of tax treaty agreements. According to U.S. Trade Representative (USTR), these taxes were discriminatorily targeted against U.S. companies. Such taxes were also imposed on a gross basis and were not creditable against the tax base these countries were seeking to expand under Pillar One. Pillar One is the attempt to upgrade the international tax system to reallocate taxation rights to 'market' jurisdictions and eliminate the discriminatory and harmful network of DSTs and other similar measures that currently threaten to proliferate globally.

The Amount A solution applies to Multinational Enterprises (MNEs and Covered Groups) with global revenue greater than EUR 20 billion and a pre-tax profit margin greater than 10 percent of total revenue. Technically, Amount A is a formulary apportionment type of taxation and seems simple enough at a high level, but the devil is in the detail. Let me just refer here to the basics.

Amount A reallocates 25 percent of the in-scope MNE profit in excess of a 10 percent profit threshold to so-called market jurisdictions. Market jurisdictions are defined as the jurisdiction where the end-user generating the MNE revenues is located. An end-user could be where a consumer buys products or where the user of a platform accesses the internet to buy a service. The Amount A allocation number is adjusted under the so-called MDSH, if it is determined that the market jurisdiction has already taxed a portion of the profit that is in scope of Amount A. The Amount A calculation identifies the jurisdiction(s) that must relieve double taxation, which jurisdiction might or might not include a business connection to the market jurisdiction. Amount A is a novel regime that applies on top of the U.S. international tax rules for approximately 50 in-scope U.S. multinationals. The revenue threshold for the Amount A scope will be reduced to EUR 10 billion in seven years from the MLC's effective date, if the MLC were to advance in the U.S., subject to a prior multilateral review of its effectiveness.

Amount A was originally proposed to apply to consumer-facing businesses and automated digital services for MNEs that had annual revenue over EUR 750 million. As a result of the inherent difficulties in attempting to 'ring-fence' certain portions of the economy and at the behest of the Trump and then Biden Administrations, the scope of Amount A was altered to define highly profitable MNEs with revenue above EUR 20 billion. Informal analyses indicate that about 100 MNEs across a variety of industries globally would be in scope of the Amount A rules if it were in effect today.

To simplify, there is a five-step approach to determining and managing an MNE's Amount A liability.

Step one: Determine if the MNE is in scope.

Step two: Identify eligible market jurisdictions.

Step three: Calculate and allocate by a revenue-based formula a portion of the MNE excess profit.

Step four: Eliminate double taxation.

Step five: File, pay, and have access to certainty (for Amount A *and* related issues).

Observations on Detailed Components of the Multilateral Convention

Achieving these steps requires the application of a number of new technical methods and policies, which we have commented on in more detail per our public consultation letters. We would like to share some highlights from our prior letters here.

Autonomous Domestic Business Exemption

USCIB welcomes the inclusion of the autonomous domestic business exemption ("ADBE") concept in the computation of Amount A. There is work to be done on refining the rules of its application, however. In many instances the ADBE will ensure that grossly distorted outcomes will not result from the application of Amount A, e.g., when a sizable autonomous domestic business experiences profit margins that vary significantly from the overall group. The ADBE is intended to exclude the profits of an autonomous domestic business from being inappropriately included in the Amount A base for the global profit reallocation. In the case of a U.S. group with mature, high-margin domestic stand-alone businesses, the domestic business exception will ensure that the U.S. tax base is not inappropriately subjected to reallocation under Amount A.

Marketing and Distribution Profits Safe Harbor

The OECD described the premise of the MDSH as follows. Amount A should be allocated to a market jurisdiction that is not taxing residual (or non-routine) profits under the existing profit allocation rules in place today. Amount A should not be allocated to a market jurisdiction where an MNE group already leaves sufficient residual profit that is taxed in the market. Conceptually, the MDSH would adjust the quantum of Amount A allocable to a market jurisdiction where the residual profit of the MNE group is already taxed in that jurisdiction as a result of the application of the existing profit allocation rules.[1]

USCIB members remain concerned that the MDSH does not adequately deliver on the objective to avoid double taxation. This is based on USCIB member initial modeling of the impact of the MDSH rules in the current version of the MLC. This means that the current design of the MDSH will frequently not cap the allocation of Amount A to market jurisdictions that already have taxing rights over the residual profits of a Covered Group. USCIB members are particularly concerned by the following design features that limit the effectiveness of the MDSH:

1. *De minimis* threshold of EUR 50m in profits (i.e., market jurisdictions below EUR 50m of profit are not included in the MDSH and receive a full Amount A allocation);
2. Determination of routine profit under a formulaic approach;
3. Proposed jurisdictional offset percentages that are the result of political negotiation;
4. Formulaic reductions to the Withholding Tax Upward Adjustments that may not fully relieve double taxation; and
5. Risk that these design features are amended in the future, especially if market jurisdictions are not satisfied with the Amount A outcome under the current formula.

MDSH and Withholding Taxes

The treatment of withholding taxes is of particular concern to our members. MNE modeling exercises reveal that withholding tax adjustments may be the primary determinant for whether the MDSH is effective in avoiding double counting of taxable profits in market jurisdictions. We understand the countries objecting to the withholding tax offset features within the MLC are some

[1] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Page 124, paragraph 501.

of the primary countries for which this calculation holds true. The reliability of the MDSH as a guardrail against double taxation will be diluted if an effective withholding tax adjustment is not provided in the final MLC text.

It is a positive step that the MLC (through the MDSH) recognizes that market jurisdictions can and do use withholding tax to tax Covered Group's residual profits, and that withholding taxes should therefore be accounted for in the MDSH. The Withholding Tax Upward Adjustment is subject to three separate limitations, a reduction factor varying between 15 percent and 70 percent, an exclusion for normal (or routine) profit, and the jurisdictional offset percentage. The effect of this means that the amount of profit accounted for when computing the MDSH will typically be 20 percent to 50 percent of the Withholding Tax Upward Amount (i.e., the profit that would need to be booked in a jurisdiction to give it equivalent taxing rights to the amount of withholding tax imposed).

USCIB members consider that there should be no reduction to the Withholding Tax Upward amount, in other words, that 100% of the relevant withholding tax imposed should be included in the MDSH calculation. The modeling indicates that the withholding tax adjustments are critically important in policing jurisdictions from double counting both Amount A and other source-based taxation methods on non-routine profits.

Moreover, where withholding taxes are not fully creditable or otherwise offset against amounts reallocated under Amount A, countries will have an incentive to override the Pillar One agreement through increases to withholding tax rates and a broadening of the scope of withholding taxes, such as through the assertion of the existence of embedded royalties.

Revenue Sourcing

We welcome the simplification of the MLC sourcing rules in response to the business community's input on the earlier OECD design drafts. However, we believe the current rules remain excessively burdensome and will lead to considerable implementation challenges. These rules can be further simplified and made more practical. We are concerned that the sourcing rules for many business-to-business revenues will nearly always result in the default selection of an OECD designed allocation key or in the use of a novel (or bespoke) sourcing methodology that will have to be agreed upon with the MNE. This will either result in a distorted allocation of profits (in the case of an allocation key) or in a significant incremental compliance burden (in the case of a bespoke method). Expanding the lists of permissible indicators to include commonly available information, such as billing addresses, would more effectively address these issues.

Additionally, we appreciate that companies should be able to rely on commercial and other available information rather than the need for new reporting obligations with the same or similar information.

Elimination of Double Taxation

Since its outset, the objective of Amount A has been to reallocate taxing rights to market jurisdictions, with a corresponding reduction in the taxing rights of residence jurisdictions. USCIB members are concerned that, as drafted, the MLC's mechanism to eliminate double taxation will result in the profits of Covered Groups being subject to double taxation in some instances. The

MLC currently relies on each adopting country to utilize their domestic laws to relieve double taxation. As a result, it is not clear to USCIB members that full double tax relief will be available due to the inevitable inconsistencies across implementing jurisdictions globally.

USCIB members encourage the U.S. Treasury to work with Congress and provide taxpayers with clear guidance on how it intends to relieve double taxation arising from Amount A, and to engage with other jurisdictions that can be expected to relieve double taxation to provide clarity on the method through which double taxation arising from Amount A will be relieved.

USCIB members strongly encourage the United States to relieve the double taxation arising from Amount A by exempting the income reallocated under Amount A from U.S. tax. Members have identified several features of the existing U.S. foreign tax credit (FTC) regime that will need to be carefully considered to ensure the full relief of double taxation arising from Amount A, including U.S. source income rules, expense allocation rules, and previously taxed earning and profits rules.

Administration and compliance

USCIB members welcome the simplification and standardization of the administration and compliance framework for Amount A provided in the MLC. Members reemphasize that this simplification and standardization will be critical for Amount A to operate effectively. We look forward to the timely release of the Amount A Tax Return and Common Documentation Package so that our members can evaluate in greater detail the compliance obligations connected to Amount A.

Exchange of Information

The level of detail in the data required for calculations under the MLC is beyond any tax compliance regime in place in the world today. There are yet no clear guardrails to mitigate the risk that Amount A jurisdictions will not engage in "fishing expeditions" or that confidential taxpayer information improperly leaks over to non-Amount A jurisdictions. Further guidelines need to be developed to protect sensitive taxpayer information and to limit what is shared to information that is necessary for MLC compliance in the recipient jurisdiction. Also, more protective rules need to be in place where there are breaches of confidentiality, since there is such wide variation in the protections provided among parties in their domestic law, given the more sensitive nature of the data that is being incorporated into calculations under this MLC.

Tax certainty

While we believe that further work is needed to ensure tax certainty for tax administrations and taxpayers, we commend the novel and progressive approach to dispute *prevention* (the certainty element) and dispute *resolution* (the mutual agreement procedure ("MAP") element) provisions contained in the MLC. These new elements can be attractive to business and can be incorporated on a "best practices" basis into the existing bilateral tax treaty framework and other dispute prevention and resolution mechanisms.

In our view, positive aspects of the tax certainty provisions include the creation and focus on advance certainty provisions that can provide forward-looking and binding multilateral certainty. The provisions were also designed to amplify the existing network of double tax treaties. The tax certainty process also includes strict deadlines to ensure that inactivity on the part of one of the Parties to the Amount A MLC will not slow down and undermine the certainty process.

In contrast, the current dispute resolution and tax certainty provisions in the MLC can be further improved by ensuring that business has an active role in the dispute resolution process and providing access to certainty in the event of uncoordinated Amount A audits.

Composition of Determination Panels

Given the number of MNEs expected to be in scope for Amount A, there will be significant reallocations of U.S. MNE profits. There is likely to be frequent use of determination panels. The inclusion of non-governmental personnel on such determination panels could be inappropriate. The determination panel should be comprised of government officials from the ultimate parent entity lead tax administration, relieving jurisdiction, and market jurisdictions that are subject to government oversight. Appropriate panel design is key to the stability of the process and to the protection of sensitive and confidential taxpayer information shared as part of the process.

DST and relevant similar measures

As noted, one of the critical objectives of the Pillar One negotiation is to remove destabilizing and discriminatory tax measures that target U.S. companies. We appreciate this Committee's strong, bipartisan opposition to DSTs and other similarly targeted measures. Unfortunately, these taxes are becoming more common, and the MLC should ensure that DSTs are withdrawn. We also should ensure that they are not simply replaced by new discriminatory taxes that are designed through loopholes and ambiguous language. The MLC terms need to be clear that discrimination against non-domestic companies (including U.S. companies) will not be permitted.

We appreciate improvements made in the MLC text, including limiting loopholes like a *de minimis* exception to DST and relevant similar measures (RSM) designation or a proportionality limit, which would still permit discrimination. As mentioned in our U.S. Treasury consultation letter, however, we believe that further clarifications are needed to ensure that countries cannot use vague exceptions to push through discriminatory legislation.

Annex A to the MLC appropriately lists measures that have traditionally been considered DSTs. These measures should, of course, be withdrawn. There are some notable measures that are omitted. For example, the pending Canadian DST (discussed more fully below) is clearly of the same mold as the DSTs on the list and discriminates against U.S. companies.

The MLC should not enable countries to make a choice between Amount A and DSTs. The message from the U.S. should be that, while we are negotiating an agreement around allocation of taxation rights for certain profits, discrimination against U.S. companies should not be permitted in any case. That should never be a legitimate tax policy choice and is not simply a tax issue – discrimination through the tax system against U.S. companies is a trade issue. It must be clear, as USTR has done in the past with DST investigations, that countries who are found to act unilaterally, outside of an agreed upon framework of taxation rights, will be treated as inhibiting trade.

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While our more specific recommendations are outlined in our U.S. Treasury consultation letter, let me mention a few points that we believe are of importance in achieving the goals of the MLC.

Article 39 of the draft MLC sets a threshold that, if measures "in practice exclusively or almost exclusively" target non-resident or foreign-owned businesses, the measure will be considered discriminatory. It is important that we are all aligned that these terms encompass both *de jure* and *de facto* discrimination. It is certainly our view that any tax measure that predominantly taxes non-resident companies, including business models that are predominantly from other countries, is discriminatory. That is what we are seeing happening to U.S. companies under DSTs. It is important that the term “exclusively or almost exclusively” is not defined too narrowly or else it simply establishes a loophole for further discrimination. Some clarifications, including perhaps some more instructive examples in the guidance, are needed to ensure the effectiveness of these provisions. Also, it is important to clarify that this measure could be based on tax revenues collected, not just the number of taxpayers. A few small domestic taxpayers should not be used as justification for targeted, substantial taxation of another country’s companies.

We are also concerned about the level of subjectivity in the provisions in Article 39 that test if a measure is "insulating domestic businesses." There is an exception for “policy objectives,” meaning that *de jure* or *de facto* discrimination can be permitted if it is tied to a permissible policy objective. Certainly, we believe that the intent behind this provision is narrow, but guardrails need to be added to the language to make that clearer and to set limitations. Excessive subjectivity or vagueness in setting exceptions will lead to loopholes that could undermine the fundamental objectives of these provisions. If those guardrails cannot be narrowly defined, we believe this exception should be deleted from the MLC text.

We applaud that the MLC text addresses significant economic presence provisions, although we believe there could be more clarity on the consequences for these measures.

Importantly, we have expressed our strong belief that the standstill agreement for DSTs be extended and were pleased to see that has been extended until the end of June. We are disappointed that certain countries have been grandfathered – that they are still allowed to collect DSTs from U.S. companies – but we believe it is important to avoid the proliferation of new DSTs as we are working out the terms of their withdrawal. We note, however, our disappointment that Canada has not respected the standstill and believe that their continued insistence on moving forward with discriminatory provisions puts the broader project of Pillar One at risk. One of our closest trading partners is moving forward with a discriminatory DST, including retroactivity which is particularly objectionable, and undercutting the stability and work of the OECD and the Inclusive Framework. We appreciate the letter that many members of this committee sent United States Trade Representative Tai and Secretary Yellen last September, and we ask that you continue to work closely with the administration to encourage Canada to rejoin the global consensus on DSTs.

Amount B

Amount B is considered a keystone feature of this overall project given the potential for it to deliver significant tax administration efficiencies for relatively standard transactions. Recently, Treasury publicly defined the agreement of a “robust Amount B” as a redline that must be achieved before the MLC can be accepted by the United States.[2] Simply put, Amount B is a necessary and critical element of the overall Pillar One architecture.

Similarly, USCIB views Amount B as an important opportunity for business and tax authorities, especially in developing countries ("Low Capacity Jurisdictions" or "LCJs"), to work collaboratively to achieve much needed simplification within an international tax system that has become increasingly complex and fragmented. However, the proposed design of Amount B as described in the February 19, 2024 document released from the OECD still requires significant clarifications and revisions to achieve the stated objectives. In addition, and importantly, the path to widespread adoption by tax authorities and the broad application to taxpayers, including those in the scope of Pillar One, remains unclear.

To make the most of the tax certainty benefits of Amount B and enable widespread adoption, the drafters should strive for a broad spectrum of in-scope marketing and distribution activities, a pricing methodology design that is relatively simple to apply in practice by taxpayers and tax authorities alike, and multilateral implementation that is binding on all in-scope tax administrations and taxpayers. In this regard, we recommend:

- Increase the scope of Amount B to include a broad spectrum of industries and business models.
- Clearly define the list of initial low capacity jurisdictions that will be included within the scope of the initial phase of Amount B.
- Ensure that Amount B pricing approaches are economic in nature and consistent with current international norms for the allocation of profit for distribution activities.
- Establish that Amount B pricing approaches will be accepted by both market and principal jurisdictions; without this, Amount B will increase, rather than reduce, controversies, further burdening LCJ tax authorities.
- Limit the nature of complex qualitative assessment factors that determine if a taxpayer should be in scope of Amount B.
- Develop a clear and achievable timeline for completion of the Amount B design that can be broadly implemented in a binding manner.

We are concerned that the current design of Amount B falls short of the stated objectives of the OECD as well as the stated redline from the U.S. Treasury Department of a "robust Amount B." In our view, for Amount B to be effective as a stabilizing force in the international tax framework, the OECD and Inclusive Framework must continue their efforts to negotiate and ultimately agree upon an Amount B design that is acceptable to all stakeholders and broadly adopted globally.

[2] Soong, Stephanie. "Amount B Tax Certainty Is a Red Line for U.S., Bello Says," Tax Notes." 12 Jan. 2024, www.taxnotes.com/tax-notes-today-international/oecd-pillar-1-profit-reallocation-digital-tax-repeal/amount-b-tax-certainty-red-line-u.s-bello-says/2024/01/12/7j2g1.

Closing

We believe in the value of our role to develop consensus positions of the U.S. business community that we contribute in detail to the development of these rules. Since the Pillar One solution was proposed, USCIB has offered practical solutions that will advance the design of the project underlying the MLC. We place a premium on offering specific guidance to the OECD which is shared simultaneously with the U.S. Treasury. We focus on generating guidance that will improve the workability of these novel sets of rules at the outset, if they are to take effect. Although we have not had a seat at the table in these years-long Inclusive Framework government negotiations, we can imagine a reality in which these rules can exist in some form in the interests of stabilizing the international tax system. We operate with urgency, as our goal in consultation is to promote the most workable version of these rules and we are well placed to do this.

We appreciate this Committee taking an active role in these important negotiations. We believe that any solution for U.S. companies must reflect the input of both the Biden administration and Congress, and we are encouraged by today's hearing.

In short, we believe that the *quid pro quo* for Amount A must be balanced for U.S. business. There needs to be reliable mechanisms to adjust and maintain that balance in order for business to make predictable investment decisions and to enable governments to collect taxes that are consistent with the economics of business operations. Amount B must be actively developed as best practice experience grows at tax administration and taxpayer levels. If developed and implemented correctly, Amount B can ensure an appropriate level of profit allocation to market jurisdictions, simplify tax compliance, and protect the tax base in the countries where significant capital investment and intellectual property creating activities take place. There needs to be a comprehensive solution to DSTs and other relevant similar measures within the MLC and for jurisdictions that do not sign up for the MLC. In addition, the interaction of Pillar One and Pillar Two taxes is a critical open question that must be addressed.

Thank you for this opportunity to testify today. This project is complicated and has a lot of moving parts over the next couple of months. We are at your disposal any further requests for discussion on these topics.

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Chairman KELLY. Thank you, Mr. Minor.

Mr. Sprague, you are recognized for 5 minutes.

STATEMENT OF GARY SPRAGUE, PARTNER, BAKER McKENZIE

Mr. SPRAGUE. Chairman Kelly, Ranking Member Thompson, and members of the subcommittee, thank you for the opportunity to testify today on the OECD's Pillar 1 project.

I am a partner with Baker & McKenzie based in Palo Alto, California. I have practiced international tax law for over 40 years. I am an adjunct professor of tax law at the UC College of Law, San Francisco. My testimony will address Amount B as described in the February 19 report. I provide these comments on my own behalf, and they do not necessarily reflect the views of Baker & McKenzie or its clients.

Amount B proposes a simplified and streamlined approach to set the transfer price to be paid by a market state distribution entity to acquire goods or services from a related, nonresident supplier for resale in the market state.

The essential premise of Amount B is to increase certainty and reduce controversy for taxpayers and tax administrations with respect to relatively straightforward transactions. It potentially applies to all MNC groups, not just the small number of Amount A taxpayers.

Amount B is also an integral part to the Pillar 1 project to restore stability to the international tax framework. The instabilities arising from DSTs and other unilateral measures are well known. Less well publicized are the instabilities created by aggressive transfer pricing positions taken by various foreign tax administrations related to the inbound distribution of goods and services, particularly those of U.S. MNCs. Amount B is designed to stabilize cross-border tax risk arising from those transactions.

In its current state, however, the Amount B proposal is not likely to achieve its stated goals. The three major issues are the narrow scope of industries covered by Amount B, adopting the rules is completely optional for all jurisdictions, and the possibility that a further subject development will be introduced to the scoping criteria. U.S. Treasury has publicly remarked on those deficiencies.

The Amount B report expressly excludes the distribution of software and digital services. This exclusion precludes Amount B benefits for some of the most innovative and dynamic sectors in the U.S. economy. This also removes Amount B protections for many of the U.S. enterprises which have experienced the sort of aggressive transfer pricing assertions outside the United States that helped inspire the idea of Amount B in the first place. At a minimum, any Amount A taxpayer in any sector should be brought within scope of Amount B.

The second significant deficiency is the permission granted to all jurisdictions to opt out of the Amount B regime. That optionality will impair the benefits and predictability and stability for U.S. MNCs.

These are not theoretical concerns. Immediately upon the release of the report, New Zealand announced that it will not participate in the Amount B project and will not regard any application of the Amount B pricing matrix as evidence of arm's-length pricing. Australia followed soon thereafter with the statement that it favors optionality.

The third major issue is the possibility that an additional optional qualitative scoping criterion might be added to the Amount B rules. The effect will be to introduce a subjective step that jurisdictions may use to exclude distributors from Amount B. India has stated its support for this approach.

So here are some suggestions for a way forward. There is no need for negotiations over the terms of Amount B to cease. Amount B will be incorporated into the OECD transfer pricing guidelines not in a multilateral treaty. The scope of Amount B could be widened to include digital goods and services in the future.

If the initial Amount B guidance retains its current limited scope, the OECD should commit to a workstream and provide a timeline to identify the appropriate comparables for the distribution of digital goods and services so that those sectors can be brought into the simplified and streamlined approach. I was pleased to see recent comments by U.S. Treasury that the U.S. is still working towards a mandatory Amount B.

Further, the IRS should consider negotiating competent authority agreements with major U.S. trading partners to achieve broader coverage and mandatory treatment on a bilateral or multilateral basis. Those agreements can build on the work already accomplished at the OECD.

The pricing mechanism described in the Amount B report is well founded in transfer pricing theory and could easily be integrated into a competent authority agreement. U.S. leadership on that point will be useful to counteract the negative drag on the initiative created by tax administrations publicly embracing optionality or opting out together.

Thank you for your attention, and I would be pleased to respond to any questions from the subcommittee.

[The statement of Mr. Sprague follows:]

Baker McKenzie.

Written Testimony of Gary D. Sprague, Baker & McKenzie LLP
Before the House Committee on Ways & Means, Subcommittee on Tax
"Ensuring the Biden Administration Puts Americans First"
March 7, 2024, 2 P.M.

Chairman Kelly, Ranking Member Thompson, and Members of the Subcommittee:

I am pleased to offer testimony today on the topic of the OECD's Pillar 1 project. I am a partner with Baker & McKenzie LLP, based in Palo Alto, California. I have practiced international tax law for over 40 years. I am an adjunct Professor of international tax at the UC College of the Law, San Francisco. My testimony will address Amount B as described in the OECD report issued February 19, 2024 (the "Amount B Report"). I provide these comments on my own behalf.

Current State of Transfer Pricing Disputes Relating to Distribution Activity

Across the world, countries generally have adopted the arm's length principle to test the prices charged between related parties engaging in cross-border transactions, as reflected in the OECD's Transfer Pricing Guidelines ("TPG") and the U.S. Treasury section 482 regulations. As relevant to Amount B, the transactions in question are the prices to be paid by a distribution entity established in a market state to acquire goods or services from a related, nonresident supplier to be resold to customers in the market state. The price paid then determines the taxable profits to be recognized by that entity for its distribution functions.

The OECD reports that the number of Mutual Agreement Procedure ("MAP") cases opened for transfer pricing matters has spiked since 2016.[1] With respect to U.S. MNCs, that increase reflects an increase in the number of non-US transfer pricing disputes worldwide. Similarly, the IRS publishes statistics on its completed Advanced Pricing Agreements ("APA").[2] IRS figures show an increase in the number of cases related to distributors from approximately 39% in 2018[3] to around 53% in 2022 - the latest year of reported executed APAs.[4] Of all tested parties[5] in closed APA cases, in 2018 non-U.S. distributors constituted 7%,[6] while they constituted 19% in 2022.[7] This demonstrates that U.S. taxpayers have been required to devote considerably more resources to resolving foreign distribution cases in recent years.

APA statistics reflect voluntary requests by taxpayers to resolve in advance their transfer pricing positions. Accordingly, the APA statistics also demonstrate that U.S. taxpayers increasingly value predictability and stability in the pricing of their distribution relationships. Anecdotally, the increased

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[1] OECD Mutual Agreement Procedure Statistics 2022 – Inventory Trends, https://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics-2022-inventory-trends.htm#tpcases (last visited March 4, 2024) (*see* "Inventory Trends for Transfer Pricing Cases"). A MAP case is an intergovernmental consultation triggered under a tax treaty when one tax administration makes an adjustment to a reported transfer price. *See also*, Internal Revenue Service, *Overview of the MAP Process*, Overview of the MAP Process | Internal Revenue Service (irs.gov).
[2] In an APA, the IRS agrees with a counterparty tax administration to the price to be charged in a transaction between a U.S. taxpayer and a foreign affiliate.
[3] "Announcement and Report Concerning Advance Pricing Agreements" (https://www.irs.gov/pub/irs-apa/announcement_2019-03_apa_report.pdf) , APMA Program, March 22, 2019, page 9.
[4] "Announcement and Report Concerning Advance Pricing Agreements" (https://www.irs.gov/pub/irs-drop/a-23-10.pdf) , APMA Program, March 27, 2023, page 9.
[5] In this context, the "tested party" is the entity engaging in local distribution activity.
[6] "Announcement and Report Concerning Advance Pricing Agreements" (https://www.irs.gov/pub/irs-apa/announcement_2019-03_apa_report.pdf) , APMA Program, March 22, 2019, page 9.
[7] "Announcement and Report Concerning Advance Pricing Agreements" (https://www.irs.gov/pub/irs-drop/a-23-10.pdf) , APMA Program, March 27, 2023, page 9.

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demand for APAs related to foreign distribution is a response to the increased level of foreign-initiated controversies over the pricing of local distribution functions in recent years. The OECD press release on the Amount B Report noted that "[s]everal low-capacity countries report that between 30–70% of their transfer pricing disputes relate to baseline marketing and distribution activities."[8]

Transfer pricing disputes impose significant costs on taxpayers. In essentially all cases, a transfer pricing dispute involves a question of how an enterprise's tax base should be allocated between the two jurisdictions involved in the dispute. Transfer pricing issues are by their nature factually intensive, and outside of the distribution context, potentially can give rise to a wide range of results. Taxpayers must bear significant costs of compliance through preparing contemporaneous transfer pricing documentation, as well as the costs of responding to audits and managing actual disputes. Tax administrations bear the costs of auditing transfer pricing arrangements and managing the controversies. Ultimately, taxpayers bear the cost of unrelieved double taxation if the two tax administrations involved do not agree on the ultimate allocation of tax base. The uncertainty created by the possibility of future transfer pricing disputes imposes its own costs on business in the form of lack of predictability of the group's tax expense. Double taxation could disincentivize business investment and economic growth.

The transactions potentially subject to pricing under Amount B by definition relate to distributors which do not exploit material intangible assets in their business, and do not perform material other value-added activity beyond distribution. Accordingly, in principle, the range of possible profit results under normal applications of the arm's length principle for entities with that functional profile should be relatively narrow.

The essential promise of Amount B was to produce a simplified and streamlined approach which will increase certainty for taxpayers and tax administrations, and reduce the costs of controversies over what should be regarded as relatively straightforward transactions which could produce only a limited range of pricing results. This would increase certainty and limit compliance costs associated with simple distribution relationships, to be commensurate with the relatively small amount of income in dispute.

The Stated Purpose of Pillar 1 Is to Restabilize the International Tax Framework

The stated purpose of the OECD / Inclusive Framework Pillar 1 project is to restore stability to the international tax framework. That framework has been put under considerable stress in recent years as jurisdictions have enacted different types of unilateral tax measures in an effort to reallocate to market states the tax base historically residing in residence jurisdictions. Digital services taxes ("DSTs") are the most well known of these unilateral measures, but other types of taxes, such as rules that deem a nonresident to have nexus in the market state, also have started to appear.

Less well publicized are the instabilities created by aggressive transfer pricing positions taken by the tax administrations of various countries, including some of the United States' largest trading partners. Despite the relative consistency in the legal framework applying the arm's length principle, U.S. MNCs have experienced increasing numbers of disputes with market state tax administrations related to the pricing of the inbound distribution of goods and services.

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[8] OECD, "Tax Challenges Arising From Digitalisation: Release of Amount B Report to Simplify Transfer Pricing Rules and Conforming Changes to the Commentary of the OECD Model Tax Convention, https://www.oecd.org/tax/transfer-pricing/release-of-report-on-amount-b-relating-to-the-simplification-of-transfer-pricing-rules-and-conforming-changes-to-the-commentary-of-the-oecd-model-tax-convention.htm (Feb. 19, 2024).

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Aggressive Transfer Pricing Assertions Have Contributed to Tax Framework Instability

The effect of an aggressive allocation of profit to a local distributor is to reallocate tax base from the residence state to the market state. If the residence state grants a foreign tax credit or other tax relief, the tax cost of the aggressive allocation is borne by the residence state. If the taxpayer is unable to obtain a foreign tax credit or other double tax relief, the result is unrelieved double taxation.

Many of these disputes have arisen recently with respect to local entities which are engaged in the routine functions of distributing goods and services. In principle, the transfer pricing analysis of a routine distributor should be relatively straightforward, as such an entity does not exploit material high value intangibles and does not assume unusual commercial risks.[9] U.S. MNCs nevertheless have experienced in recent years a significant increase in transfer pricing disputes relating to those transactions. Those disputes require significant resources from both taxpayers and tax administrations, despite the fact that they are relatively routine transactions.

The consequences to the U.S. tax base can be illustrated with a simple example. Assume a U.S. parent entity which designs, develops and produces a product in the United States, and which establishes distributors in several market jurisdictions to perform routine distribution functions, *i.e.* they do not exploit material intangibles. The U.S. entity has taken the entrepreneurial risk and incurred the related investment costs, and deserves under transfer pricing principles the returns to those entrepreneurial functions. The transfer price charged to the market state distributor should be set so that the distributor earns only a routine return for the distribution function. In the event that the local tax administration allocates additional income to the distributor, that income is taken from the U.S. tax base, and reduces the entrepreneurial return that is subject to U.S. tax. The increasing prevalence of these disputes has contributed to destabilizing the international tax environment.

Amount B Is an Integral Part of Pillar 1 to Restabilize the International Tax Framework

Amount B has been an integral part of the Pillar 1 project from the project's inception. Amounts A and B were designed to create greater stability for taxpayers and tax administrations in combination through complementary mechanisms. The two elements of Pillar 1 apply very different mechanisms; Amount A allocates a certain percentage of residual profits to market states on a formulaic basis, while Amount B seeks to enforce compliance with the arm's length standard for baseline distribution functions through a standard "simplified and streamlined approach" based on the arm's length principle. While different mechanisms, they share the common purpose of promoting stability and predictability.

The Amount B pricing mechanism will, in principle, apply to all in-scope taxpayers that engage in routine distribution activity. Amount A, in contrast, applies only to a small number of large global companies. The Amount B mechanism as it was originally conceived held the promise of creating a widespread benefit of reducing controversy and increasing certainty for taxpayers and tax administrations across a wide variety of industries and geographies, and for both large and small MNCs.

Amounts A and B are linked as complementary parts of the overall Pillar 1 project. The Amount A mechanism directly addresses the demand by some countries for a mechanical allocation of taxable profit based on sales into a market, while Amount B provides the complementary taxpayer-favorable element that

[9] The analysis should be relatively straightforward under both the transactional net margin method ("TNMM") (per OECD TPG) and the comparable profits method ("CPM") (U.S. section 482 regulations).

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once the market state receives the unprecedented reallocation of tax base under Amount A, the market state should remain faithful to the arm's length principle as applied to related party distributors.

The Strength of the Amount B Concept Lies in a Principled Pricing Matrix

At the core of the Amount B Report is the concept that companies can be classified according to the criteria reflected in the pricing matrix, and that benchmark returns can be applied to each of the categories that are reasonable approximations of the arm's length return that would be earned by routine distributors exhibiting those economic characteristics.[10] The Amount B Report states that the pricing matrix has been based on a review of global comparables. U.S. MNCs certainly agree that the pricing matrix must be based on a review of actual comparable entities, and it appears that that has been the case here.

It is unfortunate that the OECD has not yet released details of the global comparables set used to set the returns in the pricing matrix. Absent insight into the actual comparables relied upon to populate the pricing matrix, it is not possible to provide specific comments on the reliability of those comparables to determine returns for routine distribution activity. U.S. MNCs have provided to the OECD comparables-based analyses that conclude that arm's length returns for routine distribution activity generally are consistent across the globe, without regard to industry sector, geography, or level of profit of the global consolidated group. The convergence of most industry sectors into a single Industry Grouping 2 in the Amount B Report suggests that the OECD broadly agrees with those observations made by U.S. MNCs.

Deficiencies of the Amount B Report Which Impair the Restabilization Goal

In its current state, the Amount B Report is not likely to achieve the expectation that a simplified and streamlined approach could be broadly adopted and lead to a material reduction in transfer pricing disputes. The three major issues are: (i) the narrow scope of industries covered by Amount B; (ii) the adoption of the simplified and streamlined approach is completely optional with jurisdictions; and (iii) the apparent intention that a further subjective (and optional) element will be introduced to the scoping criteria, which will erode the goals of simplicity and certainty. U.S. Treasury has noted these deficiencies.[11]

1. The Defined Scope Excludes Many of the US's Most Dynamic Industries

The Amount B Report limits the application of the simplified and streamlined transfer pricing approach to buy-sell marketing and distribution transactions where the distributor purchases goods from one or more associated enterprises for wholesale distribution to unrelated parties.[12] The distribution of non-tangible goods, services and commodities are expressly excluded. The principal deficiencies in this scope definition are (i) the exclusion of non-tangible goods and services, and (ii) the exclusion of activities which are not wholesale distribution.

The excluded sectors represent some of the most innovative and dynamic sectors in the U.S. economy. U.S. software, digital goods, digital services and other service providers typically endeavor to expand their international sales from an early stage of their development. Those sectors continue to grow at rates that

[10] Amount B Report, section 5.1.
[11] Stephanie Soong, *Amount B Certainty Is a Red Line for U.S., Bello Says*, TAX NOTES, Jan. 12, 2024 ("The third condition is securing an effective amount B, according to Bello. 'We think of amount B as a living, breathing tax certainty provision, if we get it right,' he said. 'Our red line with respect to amount B is that amount B needs to be robust. It needs to actually clearly apply to real taxpayers that have real transactions, and it needs to provide meaningful tax certainty.'")
[12] Sales agencies and commissionaires involved in those transactions are included.

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exceed that of the U.S. economy as a whole.[13] They also achieve a greater percentage of their sales outside the United States compared to more traditional tangible goods makers.[14] Excluding those industries thus precludes some of the most innovative and dynamic enterprises in the U.S. economy from the benefits of the simplified and streamlined method.

Enterprises operating in those sectors report that they have been subject to a disproportionate amount of aggressive transfer pricing adjustments with respect to their non-U.S. distribution activity. Excluding those sectors removes Amount B protections from enterprises which have been experiencing the sort of aggressive transfer pricing assertions that inspired the idea of Amount B in the first place.

Enterprises in those sectors have been complying with all U.S. and foreign country transfer pricing documentation requirements for their local distribution activity. Those enterprises report that they have been able to find global, regional or country specific comparables appropriate to apply the CPM / TNMM to their distribution activity. Accordingly, there does not appear to be a technical reason to exclude non-tangible goods and services from the coverage of Amount B.

The Amount B Report does not explicitly explain why software, digital goods and services distribution have been excluded. The Amount B Report does state that the simplified and streamlined approach applies to qualifying transactions "involving the distribution of tangible goods for which there is broad consistency in the overall supply chain and functional analysis."[15] That text implies a view that a similar consistency does not exist for transactions involving the distribution of non-tangible goods or services.

The structure of Amount B does not require consistency across all distribution entities. It applies only to those distribution entities which perform a set of core distribution functions, which can be reliably priced using a one-sided method, and which incur annual operating expenses within a stated band relative to the entity's tested revenues. This definition causes the simplified and streamlined method to apply only to those entities for which it is appropriate. If some distributors of non-tangible goods and services do not fit with those parameters, that is no reason to exclude those that do. Furthermore, the pricing matrix itself exhibits a wide range of possible results, from 1.5% to 5.5% return on sales (before the application of market risk adjustments). That is a notably wide range of results for baseline distribution activity. There is no reason to believe that distributors of non-tangible goods and services will not find their appropriate place in that pricing matrix, along with functionally similar distribution entities in other industry sectors.

The fact that resellers of services do not acquire and dispose of title to goods is not a reason to exclude non-tangible goods or services. First, a routine distributor's principal functions are to market the goods or services, locate potential customers, engage in sales solicitation, conclude the transaction, and support the customer with ongoing needs. Those functions are identical for distributors of tangible goods, non-tangible goods, or services.

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[13] Tina Highfill and Christopher Surfield, *New and Revised Statistics of the U.S. Digital Economy, 2005-2021*, U.S. Department of Commerce, Bureau of Economic Analysis (Nov. 2022), *available at* https://www.bea.gov/system/files/2022-11/new-and-revised-statistics-of-the-us-digital-economy-2005-2021.pdf ("Growth in price-adjusted GDP (also referred to as "chained-dollar" or "real" GDP) was 9.8 percent in 2021, greatly outpacing growth in the overall economy, which increased 5.9 percent."). *See also* MarketLine Industry Profile: Global Software, April 2023.

[14] United Nations Conference on Trade and Development, *How Digital Multinationals are Transforming Global Trade and Investment* (May 16, 2022), *available at* https://unctad.org/news/how-digital-multinationals-are-transforming-global-trade-and-investment (Since 2016, Digital MNEs' "foreign asset footprint has decreased, while foreign sales have grown. The ratio between the latter and the former is up by 11%, with most of the rise taking place in 2021.")

[15] Amount B Report, para. 25.

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Second, sales agents and commissionaires are expressly included in scope. Those business models involve commercial intermediaries which do not take title to tangible goods. If the pricing matrix is based on comparables appropriate to price sales agents and commissionaires, there is no reason to believe that those comparables can't also support pricing for distributors of digital goods and services.

The exclusion of software, digital goods and services also is perplexing since the cross-border supply of digital goods and services was one of the principal impetuses behind the Amount A design. Pillar 1 as a whole was designed to respond to the tax challenges of the digitalized economy. The principal "tax challenge" was how national tax law should address remote supplies of digital goods and services to customers without the supplier establishing the type of local sales presence that had been common in other sectors.

At the national level, several countries did not wait for the development of an Amount A proposal and instead imposed unilateral taxes on digital service providers, notably the DST. It is particularly unfortunate that the current Amount B scope expressly excludes those companies which were the impetus for the Amount A design and are the sole subjects of the DSTs.

Even if digital goods and services are not brought into the scope of Amount B, any Amount A taxpayer should be able to obtain the benefits of the simplified and streamlined approach. Actual Amount A taxpayers should benefit from the interdependency between the complementary Amounts A and B regimes to restabilize the international tax framework.

There is no reason that the scope of Amount B can't be widened to include digital goods and services in the future. If Amount B retains the current limited scope, the OECD should commit to a workstream and provide a timeline to identify the appropriate comparables for the distribution of digital goods and services so that those sectors can be brought into the simplified and streamlined approach. In the meantime, it should be made clear that the Amount B pricing matrix should not apply to out of scope transactions, and in particular should not be viewed as a "floor" for pricing the distribution of services and non-tangible goods.[16]

2. Optionality in the Amount B Report Seriously Impairs the Goals of Achieving Stability

The policy goals of Amount B are: (i) to reduce disputes over what should be less controversial intercompany transactions; (ii) to enforce the norms of the arm's length principle in an environment where some jurisdictions have endeavored to reach into nonresident residual profits through transfer pricing adjustments; and (iii) to provide workable tools for low capacity jurisdictions to apply transfer pricing rules for inbound distribution in their jurisdiction. Those goals are undercut by the permission granted in the Amount B Report that allows all jurisdictions, without limits, to opt in or out of the Amount B regime. That optionality will impair the hoped-for benefits of predictability and stability for U.S. MNCs.

These concerns have been manifested already. Immediately upon the release of the Amount B Report, New Zealand announced that it will not participate in the Amount B project, and will not regard any application of the Amount B pricing matrix as evidence of arm's length pricing. Australia followed soon thereafter with a statement that it favors the optionality permitted in the Amount B Report.

[16] The OECD should clarify that the simplified and streamlined approach applies to B2B transactions where the business customer acquires the goods for its own use or for incorporation into another product. The definition of "wholesale distribution" includes distribution to any type of customer except end consumers. That suggests that B2B transactions are within scope, although B2B sales for final use by the B2B customer normally are not referred to as "wholesale distribution".

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U.S. MNCs generally believe that the simplified and streamlined approach should be mandatory for tax administrations. The Amount B regime will be included in the OECD's TPG. New Zealand and Australia are both OECD members. Their early declarations may give other tax administrations cover to also back away from a commitment to apply the simplified and streamlined approach. Double taxation is inevitable if one jurisdiction does not regard an adjustment by the counterparty jurisdiction as legitimate, as correlative relief then becomes unavailable.

Ideally, OECD/IF members will continue to negotiate the simplified and streamlined approach towards the goal of becoming mandatory at least for all OECD members, and other jurisdictions which choose to follow the OECD TPG for their transfer pricing guidance. Failing that, the IRS might consider negotiating Competent Authority Agreements with the major U.S. trading partners to achieve mandatory treatment on a bilateral (or multilateral) basis. U.S. leadership on that point will be useful to counteract the negative drag on the initiative created by tax administrations publicly embracing optionality or opting out altogether.

3. The Possibility of an Additional Optional Subjective Scoping Criterion Will Further Degrade Certainty and Simplicity

The Introduction to the Amount B report notes that the IF is continuing to work on an additional optional qualitative scoping criterion that jurisdictions may choose to apply as an additional step to identify distributors which perform non-baseline activities, and thus would be excluded from the simplified and streamlined approach.[17]

U.S. MNCs believe that any further subjective scoping criterion will lead to further uncertainty. The Amount B Report sets out three principal layers of criteria necessary to define transactions in scope and to determine a price: (i) the objective scoping criteria set forth in section 3.2 of the Amount B Report; (ii) the pricing matrix itself based on a careful review of the comparables and differentiated by industry groupings and levels of operating asset and operating expense intensity relative to sales; and (iii) an operating expense based cap and collar to the pricing matrix results. This triple definition to determine a price is directly supported by transfer pricing theory and is based on comparable transactions. The objectivity of the various screens enhances predictability and certainty. Introducing an optional qualitative (i.e. subjective rather than objective) criterion will seriously degrade certainty and predictability for any transaction with entities operating in a jurisdiction that elects to impose that qualitative criterion. U.S. MNCs suspect that the principal consequence of imposing that additional qualitative criterion will be to exclude many of the United States' most innovative and dynamic sectors from the application of Amount B.

If the IRS does pursue Competent Authority Agreements with major trading partners, the IRS should insist that no additional qualitative criteria be considered.

The Importance of Amount B Is Enhanced due to the Missed Opportunity to Harmonize Amount A and Amount B through the MDSH

The purpose of the marketing and distribution safe harbor ("MDSH") in the Amount A structure is to preclude a jurisdiction from double dipping into the residual profits of nonresident group entities. Notionally, any jurisdiction which is a party to the Multilateral Convention implementing Amount A would be entitled to tax its full share of the nonresident group's residual profits as attributed to that jurisdiction based on sales sourced to that state. If that market state has already taxed some part of the group's residual profits through other mechanisms, however, there is no basis to allocate the full notional Amount A to that

[17] Amount B Report, p. 6. *See also* Amount B Report, footnote 4, for India's endorsement of that feature.

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jurisdiction. If the jurisdiction received the full notional Amount A allocation, it will be double dipping into the group's residual profits.

A jurisdiction which includes in its tax base the normal profits earned by a distributor performing only baseline marketing and distribution activity would not be regarded as taxing a portion of the nonresident group's nonroutine returns. If the group's activities in that jurisdiction result in taxable profits in excess of that, however, those profits may be part of the nonroutine return, and to that extent should reduce the Amount A allocable to that state. The MDSH is the Amount A mechanism intended to achieve that adjustment.

Regrettably, the mechanism described in the MLC draft will not achieve that goal.[18] This heavily negotiated element resulted in a MDSH cap that will only partially ameliorate double dipping. A more appropriate mechanism for the MDSH would have been to set the MDSH as a hard cap, *i.e.* that the Amount A allocation would be reduced by the amount of profits already taxed in that jurisdiction beyond the cap. This is a structural feature of Amount A, not Amount B, so it should be a focus of U.S. Treasury if that element becomes open for renegotiation. In the meantime, that MDSH deficiency reinforces the need for an Amount B with wide scope to at least counter double dipping through aggressive transfer pricing assertions with respect to in-country distribution activity.

Amount B Provides Important Benefits to Low-Capacity Jurisdictions

One of the principal policy goals of the Amount B project is to provide simplified tools to allow low-capacity jurisdictions to enforce arm's length pricing rules for inbound distribution structures. The Amount B Report has succeeded in that goal. The report incudes a political commitment by IF members to respect the outcome reached under the simplified and streamlined method when applied by a low-capacity jurisdiction.

The Amount B Report includes some more questionable additional allocations for jurisdictions classified as "qualifying jurisdictions", which may differ from those classified as "low-capacity jurisdictions". Those qualifying jurisdictions can benefit from a higher operating expense cap in the operating expense cross-check formula,[19] and can enjoy an overall uplift to the pricing matrix results based on the jurisdiction's sovereign risk category.[20]

It is not clear whether those generous uplifts are based on rigorous data analysis or are more in the line of a political agreement to benefit the "qualified jurisdictions". As a matter of transfer pricing theory, there is no reason to increase the return on sales for sovereign risk when that risk is not borne by the distribution entity itself. In any event, those special considerations, if ultimately allowed, should be limited to the smaller developing countries, and not made available to larger economies.

Recommendations for a Way Forward

The Amount B proposal held out the promise of a significant reduction in uncertainty and administrative cost for both taxpayers and tax administrations. The range of possible results under the one-sided methods of CPM / TNMM for baseline distribution activity should be fairly small. The Amount B concept holds out the prospect of reducing disputes over where within that limited range of results a transaction should be placed. For U.S. multinationals, the Amount B project also held out the prospect of limiting unreasonable

[18] October 11, 2023 Draft Multilateral Convention to Implement Amount A of Pillar One, Article 5(2).
[19] Amount B Report, section 5.2
[20] Amount B Report, section 5.3.

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transfer pricing adjustments by foreign tax administrations by ensuring that in-scope baseline distribution activity would be priced according to a rigorous application of the arm's length principle.

As currently conceived, however, the project does not meet the original expectations due to scope limitations, optionality, and the lack of connection to Amount A. These deficiencies do not result from taxpayer objections to the concept of Amount B; they result from the failure of OECD / IF participants to agree on an approach to price relatively simple transactions based on the arm's principle.

There is no need for negotiations over the terms of Amount B to cease. Even if Amount B is introduced into the TPG in its current form to be effective in 2025, the United States should request further discussions to address these deficiencies. As an element of the TPG, the terms of the simplified and streamlined approach can be modified through the consensus processes at the OECD. The United States should encourage the OECD to publish a roadmap and timeline for expected further work on the Amount B project, including goals for scope expansion to cover digital goods, services, and retail sales, and mandatory application by tax administrations.

In the meantime, the IRS should prepare to negotiate Competent Authority Agreements with major trading partners to implement the Amount B concepts on a bilateral or multilateral basis, with the goal to remedy at least bilaterally the deficiencies described above. Those agreements should expand the scope of transactions covered to include digital goods and services, and should be mandatorily applicable to the respective tax administrations. The IRS could propose a limited number of years for the initial agreements in order to get the program in place and test it for efficiency.

These Competent Authority Agreements should build on the work already accomplished at the OECD. The objective scope definition, the pricing matrix segregated by relative operating expense and asset ratios, and the operating expense cap and collar are all useful mechanisms to define the in-scope transactions in an objective way and set the price based on the arm's length principle.

The IRS also could take that opportunity to revise the global data set to be more focused on comparables relevant to the particular bilateral or multilateral context. Given the evidence supplied by U.S. MNCs to the OECD as part of the Amount B project that baseline distribution returns do not vary much by jurisdiction or by sector, we expect that there would not be much, if any, variation in the ranges applicable to those enterprises brought within an expanded scope.

* * *

I would be pleased to respond to any further questions from the Subcommittee as desired.

Gary D. Sprague
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Palo Alto, CA 94304

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Chairman KELLY. Thank you, Mr. Sprague.
Mr. Bunn, you are recognized.

STATEMENT OF DANIEL BUNN, PRESIDENT AND CEO, TAX FOUNDATION

Mr. BUNN. Chairman Kelly, Ranking Member Thompson, and distinguished members of the Subcommittee on Tax, thank you for the opportunity to testify on the OECD's Pillar 1 project.

I am Daniel Bunn, president and CEO of the Tax Foundation.

I think it is best to think about this project in the context of what policymakers might value, and there are three different things that you might value. You may choose differently, but I think there are three things in this context that you might value, and I will run through them and provide a little context for each.

First, I think on a bipartisan and bicameral basis, there is a value to eliminating discriminatory digital services taxes, and I think as you hear from the witnesses today, you heard that there is more work to be done, that there is not—while Amount A does provide a potential path to eliminating some digital services, there is much more work to be done to accomplish that goal if this is going to be the path forward.

I know some members on the Republican side of this committee have worked on legislation to beef up U.S. potential retaliatory tools to countries that have unilaterally imposed these digital services taxes unfairly against U.S. businesses. And tools like that can be useful, but I am concerned, given the progress that has been made and the lack of progress, in some cases, with removing digital services, that an approach like that could spill into another round of attacks in trade war.

Another thing that you might value is control over what is the U.S. tax base. This subcommittee, the full committee, is given the responsibility for writing U.S. tax laws. What this deal would require would be, as a multilateral negotiation, some changes to the U.S. tax base and impacts on U.S. tax revenues that have already been described.

Chairman Kelly, you appropriately mentioned that there would be an outsized burden on U.S. businesses. The joint committees' analysis points this out, where 70 percent of the profits that they measured that would be in scope for Amount A would be from U.S. businesses or U.S. business segments.

Now, the $1.4 billion in revenue loss—JCT's preferred estimate—is not massive, but it is meaningful, and I think it is even more meaningful if you think of the interplay between Amount A and the global minimum tax.

These things change incentives. The global minimum tax in the Tax Cuts and Jobs Act changed incentives for where U.S. businesses or where multinationals generally might want to put their high-value assets or their high-return activities. And, if more of the high-value assets and high-return activities are in the U.S., then, over time—and if that trend continues over time—then there will be potentially more exposure for the U.S. tax base in the context of Amount A.

So we think—we need to think about these things in tandem. Those incentives are somewhat intertwined.

Finally, you may value the benefit, sometimes the cost, of being engaged in multilateral forums. Obviously, getting a deal like this together requires give-and-take across different desires from different countries, continents, and jurisdictions that may not have otherwise been interested at all in some sort of multilateral agreement.

The deal that is available now, while it has drawbacks, I think it is worth thinking of like what might happen if this falls apart. What might be next? Is it some sort of tax and trade war? Or I think it is worth the committee's time to look at what the United Nations is trying to do in setting up its own multilateral tax negotiation.

I don't know what the future looks like without an Amount A, but it is important to think through the value or, in some cases, the cost of being engaged in a multilateral way.

I will also mention that unilateral approaches—many of them taken by foreign governments—are not necessarily creating any sort of certainty for taxpayers. There are all sorts of mutations and multiplications of these digital services taxes, but there is a bias towards taxing additional profits or revenues, in some cases, in market jurisdictions.

I think some members of this committee will remember the destination-based cash flow tax debate many years ago back before the Tax Cuts and Jobs Act, and that was a bias towards taxing in the market as well, and the joint committee points out that that would have been more efficient than Pillar 1 Amount A.

And, with that, I thank you for your time, and I look forward to answering any of your questions.

[The statement of Mr. Bunn follows:]

TAX FOUNDATION

Testimony before the U.S. House Ways & Means Subcommittee on Tax

The OECD's Pillar One Project and the Future of Digital Services Taxes

March 7, 2024

Daniel Bunn

President & CEO, Tax Foundation

Chairman Kelly, Ranking Member Thompson, and distinguished members of the Subcommittee on Tax, thank you for the opportunity to testify on the Organisation for Economic Co-operation and Development's (OECD) Pillar One project. I am Daniel Bunn, President & CEO of Tax Foundation.

Tax Foundation has monitored the development of Pillar One since its origin five years ago. My appraisal of the project back in 2019 concluded with an assessment of the potential complexities, new uncertainties, and the need to eliminate discriminatory digital services taxes (DSTs).[1]

Today, those complexities and uncertainties are still present, and whether Pillar One will eliminate digital services taxes and other relevant unilateral measures is still unclear.

The draft multilateral tax treaty under Pillar One, Amount A would rearrange the rights to tax the largest multinational companies' profits. According to the OECD, taxing rights on about $200 billion in profits would be shifted to jurisdictions different from where the profits are currently being taxed. Due to tax differences in current vs. proposed jurisdictions, the changes would lead to a tax increase between $17 billion and $32 billion, based on 2021 data. This tax increase will impact many large companies, but only certain countries will receive additional revenue.

[1] Daniel Bunn, "Response to OECD Public Consultation Document: Secretariat Proposal for a 'Unified Approach' under Pillar One," Tax Foundation, Nov. 11, 2019, https://taxfoundation.org/research/all/global/response-to-oecd-public-consultation-document-secretariat-proposal-for-a-unified-approach-under-pillar-one/.

Specifically, the OECD's analysis points to revenue gains in low- and middle-income countries and losses primarily in jurisdictions often referred to as tax havens.[2]

There has been continued bipartisan support for eliminating DSTs because they discriminate against U.S.-based companies. However, even with Amount A, countries may keep their DSTs.

On the other hand, if Pillar One, Amount A is not agreed to, then DSTs will likely become even more common around the world. And the United Nations will likely seek to fill the gap in multilateral tax policymaking. Because the UN relies on a one-country-one-vote approach to decisions (while the OECD has aimed for consensus), and it has yet to set a clear policy agenda, its policy designs are difficult to predict.

Work done by members of this committee on H.R. 3665 shows the desire for stronger tools to retaliate against extraterritorial and discriminatory foreign taxes.[3] Members should be cautious about using such tools. The threat of a new tax and trade war with Europe is very real, with economic damages on both sides of the Atlantic. Retaliation does not guarantee the U.S.'s desired outcome—namely, the removal of discriminatory policies—but it will bring additional escalation and economic damages. The EU can put tariffs on U.S. exports just as easily as the U.S. can put tariffs on French wine.

Where there are opportunities to resolve disputes using either multilateral tax negotiations or leaning on the World Trade Organization, policymakers should prioritize those opportunities over retaliation.

My testimony will cover key items for policymakers to consider in the design of Pillar One, Amount A and the current situation for digital services taxes.

Digital Services Taxes

Since 2018, many countries have sought to use novel tools to tax the profits of large multinational companies in the digital sector. The most common of these tools has been the digital services tax. These policies usually apply a single-digit tax rate to the revenues of a large company.

These policies are problematic for two reasons.

First, they are discriminatory. One common model is to set a revenue threshold high enough that most businesses impacted by the tax are companies not headquartered in the implementing jurisdiction (most commonly, U.S.-based companies). Additionally, the policies are targeted at specific business lines (such as online streaming services, digital advertising, and the sale of user data). This violates the principle of neutrality.

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[2] OECD/G20 Base Erosion and Profit Shifting Project, "International tax reform: Multilateral Convention to Implement Amount A of Pillar One," October 2023, https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.htm.
[3] Defending American Jobs and Investment Act, H.R. 3665, 118th Congress (2023), https://www.congress.gov/bill/118th-congress/house-bill/3665.

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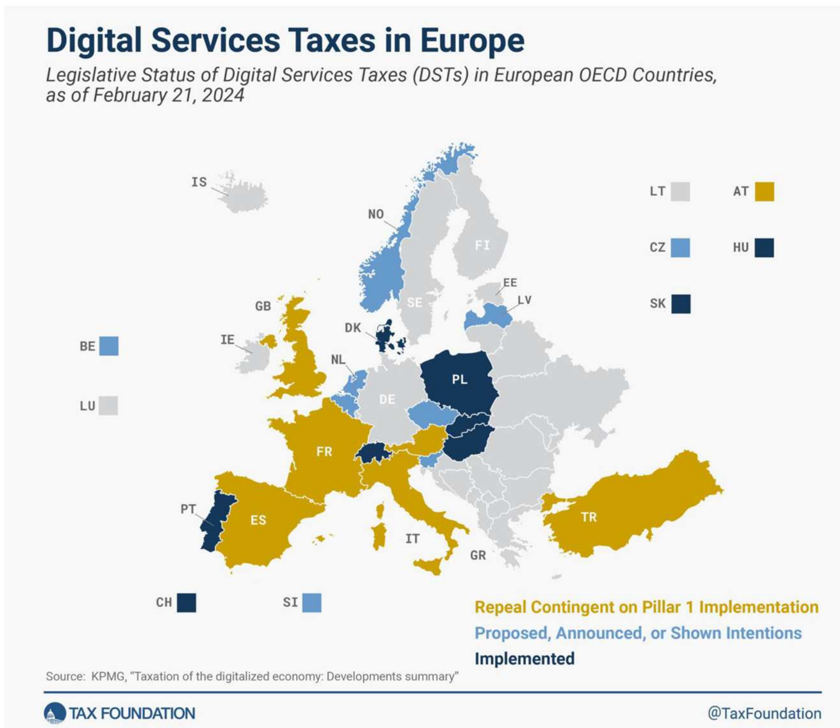
Second, they tax companies on gross revenues rather than income. This means that the tax will be owed regardless of whether a particular digital service is profitable in the jurisdiction levying the tax. Gross revenue taxation can also create tax pyramiding as costs for digital services taxes may hit a company's value chain at multiple points without the opportunity for recouping those costs.[4]



Because the United States is home to most of the companies impacted by these DSTs, U.S. lawmakers have consistently argued against the policies, including very recently in a letter from Senate Finance Chairman Sen. Wyden (D-OR) and Ranking Member Sen. Crapo (R-ID) about Canada's proposed DST.[5]

One clear goal for U.S. policymakers has been to eliminate DSTs either through a multilateral agreement or through trade threats and a potential trade war. In 2020, the Trump

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[4] Tax Foundation, "Tax Pyramiding," TaxEDU, https://taxfoundation.org/taxedu/glossary/tax-pyramiding/.
[5] Letter to Ambassador Tai from Senate Finance Committee Chairman and Ranking Member, Oct. 10, 2023, https://www.finance.senate.gov/imo/media/doc/20231010wydencrapolettertoustroncanadadst.pdf

administration announced 25 percent tariffs on $1.3 billion worth of trade with the European Union in response to the French DST.[6] These tariffs had a delayed implementation date and are currently still on hold.

Canada is the most recent entrant into the DST scene with a 3 percent rate on revenues from online marketplaces, social media platforms, sale and licensing of user data, and online ads with at least EUR 750 million (USD 812 million) in total annual worldwide revenues and Canadian revenues of CAD 20 million (USD 14.7 million).

The tax would be calculated on Canadian in-scope revenues for any calendar year that exceeds CAD 20 million. The policy has been adopted but has not yet been implemented.

Design of Pillar One, Amount A

Partially in response to DSTs, countries have been negotiating at the OECD on a multilateral solution.

Pillar One, Amount A changes the rules for where companies pay taxes. Currently, companies generally pay taxes on their profits based on where those profits are generated by employees, laboratories, manufacturing, or distribution facilities. Amount A entails a series of formulas to shift a portion of taxable profits away from jurisdictions where profits are booked currently—that is, where they are produced—and move them to jurisdictions where sales are made to final consumers.

The rules would initially impact companies with global revenues above EUR 20 billion (USD 21.6 billion at recent exchange rates) and profitability above a 10 percent margin. The revenue threshold would be cut in half after a review in the seventh year of the policy.

The rules take 25 percent of profits above a 10 percent margin and allocate that share to jurisdictions according to the share of sales in jurisdictions around the world.

The rules include approaches for identifying final consumers even when a company is selling to another business in a long supply chain. The rules also allow companies to use macroeconomic data on final consumption expenditure to allocate taxable profits when the location of final customers cannot be identified.

The rules define both where taxable profits are moved *to*, and where taxable profits are shifted *from*.

The jurisdictions that will give up taxable profits are split into different tiers according to the different ratios of profits to depreciation and payroll. This approach ensures that jurisdictions with the highest levels of profitability (compared to depreciation and payroll) will be the first to give up taxable profits to the benefit of jurisdictions where final sales are made.

These rules are incredibly complex, and it is difficult to see how they can be complied with or administered without much uncertainty and disputes over implementation.

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[6] Daniel Bunn, "Digital Taxes, Meet Handbag Tariffs," Tax Foundation, Jul. 10, 2020, https://taxfoundation.org/blog/us-french-tariffs/.

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Pillar One, Amount A Impacts

The U.S. tax base would be impacted directly by these rules. U.S. Treasury Secretary Janet Yellen has previously written that she believes Amount A would be roughly revenue neutral for the U.S.[7] For this to be true, the U.S. would need to collect significant revenue from foreign companies or from U.S. companies that sell to U.S. customers from foreign offices. Also, Pillar Two, the global minimum tax, would need to be somewhat ineffective at changing the behavior of U.S. companies to put (or keep) valuable intellectual property in the U.S. rather than placing it offshore.

More recently, Sec. Yellen has said that "significant disagreements" make determining the fiscal impact difficult.[8]

Amount A creates clear winners and losers when it determines which jurisdictions get to tax the profits in scope. If a jurisdiction has a large market, then it will likely win out from the Amount A rules. If a jurisdiction has business entities with very high profit margins, then it will likely lose taxable profits.

The U.S. has both a large market and is home to many multinationals with high profit margins.

If Pillar One Amount A gets adopted, then it will coexist with the global minimum tax. The minimum tax will, over time, change where businesses locate their high-value assets, particularly intangible property.

By many accounts, U.S. companies will bear the brunt of Amount A. What that means for the U.S. tax base is less clear.

Currently, the U.S. runs a significant trade surplus in charges for the use of intellectual property (royalties). According to data from the Bureau of Economic Analysis, that surplus has averaged $76 billion per year from 2017 to 2022. The overall trade surplus in services was $2.3 billion in 2023.[9] Additionally, year-over-year growth in private fixed investment in intellectual property (IP) products has averaged 8.7 percent since the beginning of 2017.[10]

These data are indicative of the U.S.'s strong position for trading services, many of which (particularly intellectual property services) are high value and have high profit margins. The U.S.

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[7] Letter to Senator Mike Crapo from Treasury Secretary Janet Yellen, Jun. 4, 2021, https://mnetax.com/wp-content/uploads/2021/06/Yellen_letter_to_Crapo_on_OECD_tax_negotiations920.pdf.

[8] Isabel Gottlieb, "Global Deal Disputes Prevent Exact Revenue Estimate, Yellen Says," *Bloomberg Tax*, Mar. 10, 2023, https://news.bloombergtax.com/daily-tax-report-international/global-deal-disputes-prevent-exact-revenue-estimate-yellen-says.

[9] "International Transactions, International Services, and International Investment Position Tables, Table 2.1 U.S. Trade in Services by Type of Service," Bureau of Economic Analysis, data last revised Jul. 6, 2023, https://apps.bea.gov/iTable/?reqid=62&step=9&isuri=1&6210=4#eyJhcHBpZCI6NjIsInN0ZXBzIjpbMSw5LDZdLCJkYXRhIjpbWyJQcm9kdWN0IiwiNCJdLFsiVGFibGVMaXN0IiwiMjQ1Il1dfQ==. The trade surplus could be much higher, however. In recent years, BEA data and Eurostat data have disagreed on the trade of intellectual property services; Eurostat has shown much higher trade surpluses for the U.S. with European Union Member States than the Bureau of Economic Analysis. For example, the U.S. royalties trade surplus with Ireland was nearly €100 billion ($110 billion) in 2022, according to "Balance of payments by country - quarterly data (BPM6)," Eurostat, data last updated Oct. 13, 2023, https://ec.europa.eu/eurostat/databrowser/view/bop_c6_q__custom_8779444/default/table.

[10] "National Income and Product Accounts, Table 5.6.6. Real Private Fixed Investment in Intellectual Property Products by Type, Chained Dollars," Bureau of Economic Analysis, data last revised Sep. 29, 2023.

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Treasury would likely raise less money from these companies exporting high-value services from a U.S. base if Amount A is adopted.

Furthermore, if Pillar Two works as intended (and the U.S. remains an attractive place to invest in IP), then new, valuable IP that stays in the U.S. and results in significant sales to foreign customers would further strengthen U.S. service exports and even potentially make the U.S. a net donor in the Amount A framework.

On the other hand, the U.S. may see some revenue benefits from Amount A. Some U.S.-headquartered companies that have modest profit margins within the U.S. have very high profit margins around the world (often due to IP that they hold in offshore jurisdictions). In some cases, the IP is also developed offshore. A decent share of those companies' customers may be in the U.S. So, when the profits are moved to the customers' location, the U.S. tax base for that company could grow because the most profitable jurisdictions (relative to depreciation and payroll) will be the ones giving up the tax base.

Policymakers should analyze these interactions. The difference-maker would be U.S. companies with high profit margins in foreign jurisdictions and a large portion of their sales made to U.S. customers. Even if those companies are paying tax to the U.S. via the inclusion of global intangible low-taxed income (GILTI), the rate difference between GILTI and the U.S. federal rate will increase tax revenue from those companies.

The Future of Pillar One, Amount A

Pillar One, Amount A has been negotiated by nearly 140 jurisdictions around the world, and it would require a multilateral treaty to be implemented.

This multilateral tax treaty has not yet been finalized for a couple of reasons. First, the U.S. Treasury wanted to get public input on the draft treaty. And second, several countries have expressed objections to the draft proposal.

Brazil, Colombia, and India object to several provisions, including one that suggests current taxes applied in market countries should reduce the new opportunity to tax profits allocated under Amount A. This is a question of double dipping. If a country already has the right to tax a business on its activity in a country by using withholding taxes, and Amount A would allocate new taxing rights, should the new right be a *gross* allocation or a *net* allocation? In my view, Amount A should not duplicate existing taxation that is happening in market jurisdictions.

Brazil, Colombia, and India seem to agree that Amount A should be a *gross* allocation with no offset for existing taxes owed. Other countries appear to be aiming for a *net* allocation where the Amount A taxing right is reduced by existing rights to tax in a market jurisdiction.

As of last October, these differences had not yet been resolved.

The draft treaty has a scoring system that determines when the treaty has achieved enough signatories to be implemented.[11] The key threshold for several provisions is 600 points, and 999

[11] OECD/G20 Base Erosion and Profit Shifting Project, "The Multilateral Convention to Implement Amount A of Pillar One," Table 2. Annex I, October 2023, https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.pdf#page=212.

points are available. The United States has been attributed 486 points. This means that the 600-point threshold cannot be achieved without the United States.

Therefore, the question of U.S. ratification will determine the treaty's future.

The Fate of Digital Services Taxes

A major justification for the negotiations leading to Pillar One, Amount A was the possibility of eliminating DSTs. However, even with Amount A, countries may keep their DSTs anyway.

One key element of the draft treaty released last fall is Annex A, where one can find a list of policies that will be removed once the treaty is adopted. Included in that list are the DSTs of eight countries.[12] The list is not fully inclusive of all discriminatory digital tax policies. But the draft treaty also eliminates the Amount A allocation to countries that do not remove policies that fit within the draft treaty's definition of DSTs and relevant similar measures:[13]

1. The tax is driven by the location of customers or users.
2. It is generally a tax on foreign businesses.
3. It is not a tax on income and is beyond agreements to avoid double taxation.

The incentive to remove a DST other than those already specified will likely depend on whether a country sees a better tax revenue outcome from Pillar One, Amount A. In turn, those revenue numbers will depend on how the rest of Amount A gets negotiated.

Also, it seems unlikely that these principles will result in "all" DSTs being removed as agreed in October 2021.[14] There is room for governments to work around the principles above. A DST could potentially get past the second principle by applying to both domestic and foreign businesses in a somewhat balanced way.

Five European countries have an agreement with the United States to reduce tax payments under Pillar One, Amount A in connection with the amount of taxes paid under a DST. This agreement is time-limited and will expire on June 30, 2024, unless extended further.[15]

Conclusion

With Pillar One, Amount A, very little is truly certain. It is uncertain whether a robust system for allocating profits is achievable. And even if it is, it may not result in the removal of all DSTs. The limited list and the option to retain such policies run contrary to the goals set out on a bipartisan

[12] OECD/G20 Base Erosion and Profit Shifting Project, "The Multilateral Convention to Implement Amount A of Pillar One," Annex A, October 2023, https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.pdf#page=91.
[13] OECD/G20 Base Erosion and Profit Shifting Project, "The Multilateral Convention to Implement Amount A of Pillar One," Part VI – Treatment of Specific Measures Enacted by Parties, October 2023, https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.pdf#page=77
[14] OECD/G20 Base Erosion and Profit Shifting Project, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy," Oct. 8, 2021, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf#page=3.
[15] U.S. Treasury, "The United States, Austria, France, Italy, Spain, and the United Kingdom Announce Extension of Agreement on the Transition from Existing Digital Services Taxes to New Multilateral Solution Agreed by the G20/OECD Inclusive Framework," Feb. 15, 2024, https://home.treasury.gov/news/press-releases/jy2098.

basis by members of Congress. One thing that is more certain, however, is that if a multilateral solution to remove the DSTs is not agreed to, then DSTs will continue to spread and mutate with negative impacts on some of the most innovative companies in the world.

Multilateralism is better than multiple rounds of a tax and trade war. As other countries lean toward unilateral approaches, though, it is worth recalling the unilateral U.S. approach to redefine where companies pay taxes, namely the border-adjusted tax proposal from 2016.[16]

As mentioned, the UN is building its own role in multilateral tax negotiations. In that forum, the United States and likeminded nations will likely have less leverage due to the procedural differences from the OECD.

In any case, the mess of multilateral tax policy will likely continue for some time.

[16] Kyle Pomerleau, "Understanding the House GOP's Border Adjustment," Tax Foundation, Feb. 15, 2017, https://taxfoundation.org/research/all/federal/understanding-house-gop-border-adjustment/.

Legislative Status of Digital Services Taxes (DSTs) in Select Countries, as of February 21, 2024

Country	Tax Rate	Scope	Global Revenue Threshold	Domestic Revenue Threshold	Status
Austria (AT)	5%	Online advertising	EUR 750 million (USD 813 million)	EUR 25 million (USD 27 million)	**Implemented** (Effective from January 1, 2020); joined statement on October 21, 2021, that repeal of the DST would be contingent on Pillar One implementation.
Belgium (BE)	3%	• Selling of user data • Selling advertising space on a digital platform • Digital intermediation services facilitating the exchange of supplies of goods or services	EUR 750 million (USD 813 million)	EUR 5 million (USD 5.4 million)	**Proposed** (A DST was first introduced in January 2019 but was rejected in March 2019; an adjusted DST proposal was reintroduced in June 2020). Expected to introduce one if global consensus is not reached.
Canada (CA)	3%	· Online marketplaces · Social media · Online advertising · User data	EUR 750 million (USD 813 million)	CAD 20 million (USD 14.75 million)	**Adopted, not yet implemented** (Bill C-59, which includes legislation to implement the DST, received the first reading in the House of Commons on November 30, 2023.To be effective from January 1, 2024, on revenues earned as of January 1, 2022).
Colombia (CO)	3%	· Online advertising · Digital content · Streaming · Other		USD 275,000	**Implemented** (January 1, 2024).

		digital/electronic services			
Czech Republic (CZ)	5%	• Online advertising • Transmission of user data • Digital interface to facilitate the provision of supplies of goods and services among users	EUR 750 million (USD 813 million)	CZK 100 million (USD 4.3 million)	**Proposed** (There was a proposed amendment to reduce the tax rate from 7% to 5%. However, the discussion on the bill has stalled and there is support for a DST solution at the OECD level).
Denmark (DK)	2% (3% surcharge)	On-demand, audio-visual media service providers		DKK 15 million (USD 2.2 million)	**Implemented** (Effective from January 1, 2024. There is an additional 3% surcharge for companies that invest less than 5% of their Danish revenues in Danish content. Additionally, the Finance Ministers of Denmark, Finland, and Sweden released a joint statement on digital tax, indicating that the digital and traditional economy should be taxed where value is created, and any solution reached should be a consensus-based OECD solution. However, the Danish Prime Minister announced Denmark's support to an EU-wide

					agreement on the DST controversy in case a global consensus is not reached).
Finland (FI)					The Finance Ministers of Denmark, Finland, and Sweden released a joint statement on digital tax, indicating that the digital and traditional economy should be taxed where value is created, and any solution reached should be a consensus-based OECD solution.
France (FR)	3%	· Provision of a digital interface · Advertising services based on users' data	EUR 750 million (USD 813 million)	EUR 25 million (USD 27 million)	**Implemented** (Retroactively applicable as of January 1, 2019. The 2020 DST collection was delayed to the end of 2020); joined statement on October 21, 2021, that repeal of the DST would be contingent on Pillar One implementation.
	1.2%	Paid and free access to recorded music and online music videos		EUR 20 million (USD 21.7 million)	**Implemented** (January 1, 2024. Due on amounts exceeding EUR 20 million).

Hungary (HU)	7.5%	Advertising revenue		HUF 100 million (USD 275,029)	**Implemented** (As a temporary measure, the advertisement tax rate has been reduced to 0%, effective from July 1, 2019, through December 31, 2023).
India (IN)	6%, 2%	Online advertising (6%) and sales of goods and services through e-commerce operators (2%)		INR 100,000 (USD 1,207)	**Implemented** (Effective from June 1, 2016. The Finance Act 2020 expanded the scope to include "e-commerce operators" subject to a 2% tax, effective April 1, 2020).
		Revenue from the digital PE		INR 20 million (USD 241,386)	**Implemented** (Effective from April 1, 2022).
Italy (IT)	3%	· Advertising on a digital interface · Multilateral digital interface that allows users to buy/sell goods and services · Transmission of user data generated from using a digital interface	EUR 750 million (USD 813 million)	EUR 5.5 million (USD 6 million)	**Implemented** (Effective from January 1, 2020. In November 2022, there was a proposal to increase the DST rate from 3% to 6%); joined statement on October 21, 2021, that repeal of the DST would be contingent on Pillar One implementation.
Kenya (KE)	1.5%	· Downloadable digital content · Streaming services · User data · Any other service provided through a			**Implemented** (January 1, 2021).

		digital marketplace			
Latvia (LV)	3%	-	-	-	**Announced/Shows Intention** (The Latvian government commissioned a study to determine the increase of tax revenue based on the assumption that the country levies a 3% DST. However, no further action has been taken for now).
Nepal (NP)	2%	Electronic services above NPR 2 million (USD 15,088) provided by nonresidents.			**Implemented** (July 17, 2022).
Netherlands (NL)					On October 24, 2023, the Dutch State Secretary wrote to the Dutch Parliament saying that an EU DST should be considered as an alternative to the OECD's Pillar One, Amount A if a global agreement is not reached.
Norway (NO)	-	-	-	-	**Announced/Shows Intention** (Norway plans to introduce a unilateral measure if the OECD does not reach a consensus solution; no announcements since the inclusive framework agreement).

Poland (PL)	1.5%	Audiovisual media service and audiovisual commercial communication	-	-	**Implemented** (Effective from July 2020; there is a separate proposal to introduce a 7% levy on digital sector enterprises with a significant digital presence in the territory of Poland. Additionally, a 5% levy on advertisement revenues is also discussed).
Portugal (PT)	4%, 1%	Audiovisual commercial communication on video-sharing platforms (4%), subscriptions for video-on-demand services			**Implemented** (Effective from February 2021; however, it is not applicable as regulation regarding assessment, collection and payment rules is pending).
Sierra Leone (SL)	1.5%	All electronic and digital transactions			**Implemented** (January 1, 2024).
Slovakia (SK)	5%	Payments to digital platforms facilitating transport and lodging services not registered as a PE in Slovakia	-	-	**Implemented** (January 1, 2018; additionally, the Ministry of Finance opened a consultation on a proposal to introduce a DST on revenue of nonresidents from provision of services such as advertising, online platforms, and sale of user data. However, there were no further steps taken).

Slovenia (SI)	-	-	-	-	**Announced/Shows Intention** (The Ministry of Finance announced a government proposal to submit a draft bill to the National Assembly introducing a digital services tax by April 1, 2020; however, there has been no development so far).
Spain (ES)	3%	· Online advertising services · Sale of online advertising · Sale of user data	EUR 750 million (USD 813 million)	EUR 3 million (USD 3.25 million)	**Implemented** (Effective from January 16, 2021); joined statement on October 21, 2021, that repeal of the DST would be contingent on Pillar One implementation.
Sweden (SE)					The Finance Ministers of Denmark, Finland, and Sweden released a joint statement on digital tax, indicating that the digital and traditional economy should be taxed where value is created, and any solution reached should be a consensus-based OECD solution.
Switzerland (CH)	4%	Gross income generated in Switzerland from streaming or television services		CHF 2.5 million (USD 2.83 million)	**Implemented** (Effective from January 1, 2024).
Tanzania (TZ)	2%	Digital service provided by non-residents			**Implemented** (Effective from July 1, 2022).

Tunisia (TN)	3%	Sale of digital applications and services			**Implemented** (Effective from January 1, 2020; although the law has been enacted, the implementing regulation is still pending.).
Turkey (TR)	7.5%	Online services including advertisements, sales of content, and paid services on social media websites	EUR 750 million (USD 813 million)	TRY 20 million (USD 637,828)	**Implemented** (Effective from March 1, 2020; the president can reduce the DST rate as low as 1% or increase it as much as 15%); agreed to same terms of the joint statement on October 21, 2021, that repeal of the DST would be contingent on Pillar One implementation.
Uganda (UG)	5%	· Data services · Online gaming · Digital content · Any other digital services as the Minister may prescribe			**Implemented** (Effective from July 1, 2023).
United Kingdom (GB)	2%	· Social media platforms · Internet search engine · Online marketplace	GBP 500 million (USD 633 million)	GBP 25 million (USD 32 million)	**Implemented** (Retroactively applicable as of April 1, 2020); joined statement on October 21, 2021, that repeal of the DST would be contingent on Pillar One implementation.

Source: KPMG, "Taxation of the digitalized economy: Developments summary," last updated Feb. 21, 2024, https://kpmg.com/kpmg-us/content/dam/kpmg/pdf/2023/digitalized-economy-taxation-developments-summary.pdf.

Chairman KELLY. Thank you, Mr. Bunn.

Thank you all for being here. You know, the conflict—this is so complicated. I marvel at the way you all just go through it. It is like this, this, this, and this. But for the average American to sit back and try to understand, what is it that we are trying to put together, and why is it that we are trying to put it together to begin with?

The other question I have is, is there some reason the administration didn't actually work with Congress? Because this is kind of one of our basic responsibilities. It would have been nice to be included.

So, having said all that—I am trying not to be a wise guy about this, but I am serious about this. I cannot imagine bypassing this committee and saying, we will let you know when we come up with a deal, and then you guys can just jump on and everything is going to be fine.

So please help me to understand how enacting Pillar 1 in its current form is pragmatic for the U.S. economy and, more specifically, for American businesses. Where is this—as I am an America First guy, where is this that it somehow enhances our ability to compete globally and maintain our position?

By the way, I don't want to just participate in a global economy. I want the United States to dominate it, because I think it is the only way we can save the world as we go forward.

But if any of you can help me understand this because this is so bizarre to anything I have ever come up with in my life. And, I will admit, I don't have a degree in anything that you are talking about. I would never try to do my own taxes because I know the danger, especially being a Member of Congress, if you make a mistake.

But any of you that can discuss, tell us—tell us more, if you can, how does this—where does this fit into us, and where is it that it helps America?

Ms. FUNKHOUSER. Thank you, Chairman, for the question. I think it is incredibly important and why I am so glad that we are having this hearing today because, as I mentioned in my remarks, I think the best way to have a better Amount A outcome that makes sense for the U.S. will be through congressional engagement and through opportunities like today to talk where U.S. industry sees the concerns with how it is currently drafted and work towards making it a better final package that does provide certainty and stability, because the U.S. economy benefits from the global economy. U.S. businesses are the leadership.

And so this is why we are excited to have this conversation today, just to talk through, how can we make this a better package with you?

Thank you.

Chairman KELLY. Anybody else want to weigh in?

Mr. BUNN. Sure. If I may, sir.

Chairman KELLY. Yes.

Mr. BUNN. The challenge here is avoiding what I described as a difficult digital tax and trade war. So where this began was some European countries interested in taxing in discriminatory ways in U.S. companies. And then, as the discussion developed, it was pretty clear that the way out of this was either going to be a multilateral agreement or some sort of trade war, and that is where the real impact to everyday Americans could have come down.

You know, it is not really easy to say that, oh, well, we are working towards this multilateral agreement because of X, Y, or Z. But one of the things, when we think of the prices that people face in the grocery stores or manufacturer space with their suppliers, a tax and trade war can increase those things, and I think that is one reason to continue to seek a solution to avoid that kind of outcome.

Chairman KELLY. Okay. Listen, I appreciate it so far.

And we have so many people that want to ask questions today, so I am going to now have Mr. Thompson weigh in from his side what his concerns are.

Mr. Thompson.

Mr. THOMPSON. Thank you, Mr. Chairman.

Mr. Sprague, in your written testimony, you state that the number of mutual agreement procedures, or MAP, cases opened for transfer pricing matters has spiked since 2016. You also point out that IRS figures show an increase in the number of cases related to distributors from approximately 39 percent in 2018 to around 53 percent in 2022. I would like to get a sense of the real-world impact of these disputes on our American businesses.

Based on your experience as an international tax attorney, about how much time and money do our U.S. businesses spend on these protracted transfer pricing disputes, and what impact would such an increase have on the IRS?

Mr. SPRAGUE. Mr. Thompson, thank you for that question. Your question addresses a central purpose of the simplified and streamlined approach of Amount B.

It is hard to quantify an average cost by company or by dispute, but there is no doubt that the costs are large. In many cases, large enough to make a CFO wince. So let me describe the reason why these costs are so high.

First, you referred to the MAP program, which is the government-to-government process where the two tax administrations try to resolve a dispute usually raised by the foreign tax administration. But the majority of the costs for American business are incurred before the case even makes it to MAP.

MAP is the ultimate recourse, but before a MAP case arises, the taxpayers had to address these issues on audit in front of the foreign tax administration. Those are the costs that Amount B is trying to contain.

The costs are high because transfer pricing issues are intensely factual, and there is lots of room for interpretation. So, at both the audit and MAP levels, there are substantial costs of internal resources as well as external fees. Some jurisdictions are notoriously more challenging than others. Both internal and external costs are higher for audits in those jurisdictions.

If Amount B succeeds, I would expect a reduction of burdens on taxpayers because the purpose is to provide the simplified, streamlined approach to transfer pricing for inbound distribution. And I also expect a reduction of burdens on the IRS, because if we can resolve more of these cases on audit, fewer cases then have to come to MAP, and the U.S. won't have to devote the same resources to MAP.

For those cases that do make it to MAP, I would still expect that those issues would be narrowed at the IRS, the foreign administration level, because there would be a more narrow game plan or course, if you will, to settle those disputes within the simplified and streamlined approach.

So, while I can't give you a precise number, you know, across all U.S. multinationals, it is very large, and I would expect the largest reductions in cost would be at the company level but significantly reduced at the IRS level as well.

Mr. THOMPSON. Thank you. Thank you very much.

Mr. Bunn, USTR found that the digital service tax adopted by Austria, India, Italy, Spain, Turkey, and the U.K. were subject to action under Section 301 because they discriminated against U.S. digital companies, were inconsistent with principles of international taxation, and burdened U.S. companies.

What would it take for a digital service tax to not be discriminatory against U.S. multinational corporations? Is it possible to have a DST that is not discriminatory against U.S. multinational corporations? And, if such thing could exist, would their proliferation be a desired outcome?

Mr. BUNN. Thank you for the question. In one sense, no. The U.S. has an outsized share of these large digital companies, so if you have even a digital services tax that doesn't have a revenue threshold, there would be some de facto discrimination against U.S. companies.

But if you would say that even that de facto discrimination doesn't count—you know, there is no revenue threshold or something like that—the proliferation of such a policy would still be bad. This is a tax fund on gross revenues, and countries should not be taxing businesses on their gross revenues. Net income tax is where the policy should be focused or including digital services in the context of a value-added tax or something of that nature.

Mr. THOMPSON. Thank you very much.

Mr. Chairman, I yield back.

Chairman KELLY. Mr. Schweikert, you are recognized for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

You ever have one of those cases where every time you think you start to understand something, your head starts to spin?

Mr. Sprague, I am partially going to—because of your specialty—we were back here trying to have a conversation on different ways you could have leakage, but I first want to make sure I understand some of the most basic part of the math.

I have an 11 percent gross rate of return. So 1 percent is now subject, and I take 20 percent of the 1 percent, and then that is now subject to an allocation internationally. Is that a fair way to—I am trying to make it as simple as possible. Am I okay so far?

Mr. SPRAGUE. Right.

Mr. SCHWEIKERT. For the base 10 percent that is basically sheltered, you say it is gross, but is it a classic gross as we would do our accounting in the United States of my capital expenditures, my interest costs, my caring costs, my personal costs, my healthcare costs—those as my base expenses shielded within—so I can get up to 10 percent rate of return before I am subject to the formula?

Mr. SPRAGUE. Well, yes. You are referring to the Amount A formula, you know, correct? Not the Amount B?

Mr. SCHWEIKERT. Uh-huh. Yeah. Just the A.

Mr. SPRAGUE. Yeah. And so the 10 percent is indeed on operating income, so that is after all of the normal book expenses have been deducted. So the 10 percent figure in your case would be profit after all normal expenses. And then, if your company was, in-scope, $20 billion and had 11 percent operating profit, then indeed that 1 percent would be subject to Amount A——

Mr. SCHWEIKERT. And 20 percent of the 1?

Mr. SPRAGUE. Twenty-five percent of——

Mr. SCHWEIKERT. Twenty-five percent of the 1?

Mr. SPRAGUE. Correct.

Mr. SCHWEIKERT. Okay. Now, if I came to you and said, you are my counsel. Find me a way as a—let's pretend I am an AI company. So I can put my stacks anywhere. I can put my servers here. I can move my IP anywhere, you know, and house it anywhere.

Is there a way, as you understand the model right now, to somewhat game the system?

Mr. SPRAGUE. Not really by—not by moving assets like that around because the pool of profits is global. Profit is the entire consolidated profit of the group. So you could establish a new operation in a different country and maybe earn income in that country instead of a different country, but the allocation under Amount A is based on global consolidated profit.

Mr. SCHWEIKERT. You see, part of this was—derivative was—Mr. Bunn had said, if I am in a different country and do I have different things that I could stack up as part of my expenses, my cost of doing business, either that or that country has certain different types of credit mechanics or—that would change my definition on the first base of the 10 percent.

Does that make sense, Mr. Bunn?

Mr. BUNN. So I would distinguish between what it looks like for the company, which Mr. Sprague just described, and the country.

So what I was getting at is, it depends for the country and the country's tax revenues where you have your high-value, high-margin things. The allocation for the company, you know, regardless of where they have their stuff, it will still be 25 percent of that 1 percent. But if all 11 percent of those profits are in the U.S., then it will matter for the U.S. Treasury for that 1 percent.

Mr. SCHWEIKERT. Okay. Ms. Funkhouser—and here is where we have been sort of trying to game this out in our heads and see if we are missing anything. If I am in a world—it is a decade from now—and I am running parts of my factory on AI or other types of technology in the future, or I have a company that—you know, doing synthetic biology and those things, is the design of this model, do you believe it is robust enough to handle the economic disruptions that we all expect over this decade?

Mr. SPRAGUE. On the part of the model you are describing, yes, because it just starts with, for U.S. companies, gap financial statements. So whether you are a, you know, potato chip manufacturer or an AI company or some other enterprise, it doesn't really make any difference.

Mr. SCHWEIKERT. Well, because in that AI model, you almost could have no domicile other than wherever the processors are, and the IP can—in a weird way, can almost float.

Mr. SPRAGUE. Well, I doubt a $20-billion enterprise would ever not have a domicile somewhere.

I think what you are referring to is the potential to move, as Mr. Bunn was describing, productive assets from one country to another, and that would produce more or less income in the particular country. But for Amount A purposes, you don't start with a particular country income. You start with the combined worldwide consolidated group and your gap financials.

So the consequence would be, if you put, say by virtue of AI or whatever, all of your income in one country, but you still had to allocate out some amount to other countries under Amount A, then it is that one country that would be the country that has to, you know, relieve double taxation due to the allocation out to other countries.

Mr. SCHWEIKERT. Mr. Chairman, thank you for your time. That was actually very helpful.

Chairman KELLY. Thank you.

Mr. Doggett, you are recognized for 5 minutes.

Mr. DOGGETT. Thank you, Mr. Chairman.

And thanks to each of our witnesses for your very insightful testimony.

It seems to me, whether you are a small business on Main Street or a multinational spanning the globe, one of the most important things is to have some stability, some certainty, so that when decisions are made about investing in plant and equipment, expanding a workforce, you have some sense of how much risk you are experiencing. And the less chaos we can have, the better. And avoiding a number of countries coming forward and taxing their own instead of working this out is really antibusiness in nature.

That kind of conflicts with what has been going on here in the Congress. Over the last year, we have had a substantial chaos caucus. Took us right up to the brink of defaulting on the full faith and credit of the United States for the first time in our history. It has taken us again and again right to the brink of shutting down the government. In fact, right now, we don't know if the government will shut down by the end of the month on more than half of the budget that should have been approved last September for the remainder of this fiscal year, and I hate to see that kind of chaos added to what is already a challenging multinational situation.

Ms. Funkhouser, you have referred to the need for global tax solutions, and I think you are absolutely right. Let me just ask you if you believe that the United States suddenly withdrawing from the OECD process would be harmful to U.S. business?

Ms. FUNKHOUSER. Thank you very much for the question, Congressman. And I would say yes, that would be very harmful for U.S. business, because when you think about how to secure the best outcomes for U.S. business and U.S. competitiveness, it comes from the U.S. being part of the conversation and driving the outcomes that benefit the U.S. economy and the U.S. people.

And so as we think about certainty, to your point, it is looking at how can we provide certainty for these companies.

Mr. DOGGETT. And, Mr. Bunn, you have used what is a very controversial term here in Congress with some, and that is the term "multilateralism." We have some people that don't believe in anything international, don't even support NATO these days, but you say multilateralism is better than multiple rounds of attacks in trade war.

Do you agree with Ms. Funkhouser that it would be extremely harmful to U.S. business interests to suddenly withdraw from the OECD negotiations that are still very much underway?

Mr. BUNN. I think at this point, there is a lot of work to be done, and that requires remaining engaged. The challenge is whether the goals that Congress has for the Treasury to achieve, whether those will be achieved. At some point, there will be a final deal, and that is when the decision, I think, should be made.

Mr. DOGGETT. And, Mr. Minor, while there is still much more work to be done, do you also agree that it would be a mistake for the United States to just fold up its tent and withdraw from the OECD?

Mr. MINOR. Yes. That is the clear position of my members.

And, you know, we don't have a final MLC. The Amount B rules are still in flux. So that is our recommendation, is to stay the course of the multilateral process for now, but also have a meaningful engagement between Congress and Treasury.

Mr. DOGGETT. I thank each of you for that.

Mr. Chairman, I ask unanimous consent to put into the record a letter that has been sent to the Appropriations Committee by a number of Members, including five from this Tax Subcommittee, that are urging that we end all funding for OECD and essentially withdraw from the negotiations because we won't be funding it anymore.

I think that would be a serious——

Chairman KELLY. So ordered.

Mr. DOGGETT. Mistake. I think it is antibusiness in nature. It is contrary to the needs of our business community. We need to stay engaged. We cannot wall ourselves off from the rest of the world. Our business community certainly can't do that, and they need our support. These negotiations have not achieved their full objectives yet, but that doesn't mean that you quit. We need to continue to be involved.

I would say also that there are a number of American companies who would owe tax here under Pillar 1 as currently prepared, as best I can tell, including American pharmaceutical companies that book most of their profits abroad and pay tax on little reported profit here. For example, AbbVie sells 75 percent of its drugs here in the United States, yet for years, it has reported a loss in the United States with billions in profits booked abroad.

So Pillar 1 is not just about additional tax revenue for other countries. It has some potential particularly in the pharmaceutical area here in the United States. I hope these negotiations continue and the efforts by Republican colleagues to undermine OECD will be defeated.

I yield back.

[The information follows:]

Congress of the United States
Washington, DC 20515

March 24, 2023

The Honorable Mario Diaz-Balart
Chairman
House Appropriations Committee
Subcommittee on State Department
and Foreign Operations
U.S. House of Representatives
Washington, DC 20515

The Honorable Barbara Lee
Ranking Member
House Appropriations Committee
Subcommittee on State Department
and Foreign Operations
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Diaz-Balart and Ranking Member Lee:

We write regarding Fiscal Year 2024 (FY24) appropriations for the Organisation for Economic Co-Operation and Development (OECD).

The OECD, and its predecessor organization, the Organisation for European Economic Co-Operation, have played important roles in promoting global economic development, opportunity, and transparency. However, we are concerned OECD has evolved into a venue that advocates against the economic interests of United States' workers and business through its efforts to undermine legitimate, pro-growth tax competition. The Tax Cuts and Jobs Act (P.L. 115-97) demonstrated lower tax rates and broad-based investment incentives drive economic growth, raise wages without spurring inflation, and increase tax revenue. However, OECD continues to focus on higher tax rates, corporate tax floors, and digital tax schemes that target the American tax base for taxation.

As you may know, OECD is the primary venue through which the Biden administration joined 130 nations in reaching international tax agreements on the taxation of digital services (Pillar 1) and an international corporate minimum tax (Pillar 2). While U.S. participation in Pillars 1 and 2 requires legislative action, no majority exists in the House or Senate to enact these agreements. Despite this, OECD continues to produce implementation guidance for Pillars 1 and 2, which could ultimately lead to foreign countries levying additional taxes on American companies.

OECD is funded through voluntary contributions from member states, with its Part I operating budget allocated by the size of members' economies and its Part II program budget allocated among nations based on their interest in various programs. The United States currently funds 19.1% of OECD's Part I budget, more than double any other member.

Because OECD utilizes United States' funding for the primary purpose of advocating against American families and businesses, we request you include language in the FY24 State Department and Foreign Operations appropriations bill prohibiting any funding from being provided to OECD.

We appreciate your attention to this matter and thank you for your work on State Department and Foreign Operations appropriations as the United States faces critical security challenges abroad.

Sincerely,

Adrian Smith
Member of Congress

Kevin Hern
Member of Congress

David Schweikert
Member of Congress

A. Drew Ferguson IV
Member of Congress

Ron Estes
Member of Congress

Lloyd Smucker
Member of Congress

Carol D. Miller
Member of Congress

W. Gregory Steube
Member of Congress

Blake D. Moore
Member of Congress

Beth Van Duyne
Member of Congress

Chairman KELLY. Mr. Hern, you are recognized for 5 minutes.

Mr. HERN. Thank you, Mr. Chairman.

I thank the witnesses for being here. I really appreciate it.

Since I have been on Ways and Means, I have been following this Pillar 1 issue and written multiple letters to Treasury to ask for their revenue modeling so that we better understood where their estimates were coming from and the impact of the OECD Pillar 1 agreement. And I have introduced legislation to force the Treasury to provide this information to Congress. I think it is important that we know what they are using to determine the impact. And, after years of the pressure, the Treasury finally provided the needed information to JCT.

Yesterday, JCT released a report providing background and analysis of the taxation of multinational enterprises and the potential reallocation of taxing rights under Pillar 1. JCT estimates that enactment of Pillar 1 Amount A would have resulted in a revenue loss of $1.4 billion to the U.S. fisc in 2021, ultimately confirming that this is a bad deal for Americans.

Putting the projected losses to the U.S. fisc aside, there is good reason and motivation to find a solution that would convince countries to remove and/or deter implementation of digital service taxes that target our U.S. businesses with malign intent.

But herein lies the problem. The treaty, as it is written now, does not completely solve the problem, which is to eradicate all novel extraterritorial digital service taxes and other discriminatory measures. Also, I am concerned that countries will still be able to aggressively target U.S. companies while claiming their revenue reallocation.

It is clear that the negotiation was conceived as an economical solution and one worth pursuing, but has quickly turned into a political negotiation with massive amounts of complexity and key economic principles missing from the final product.

There is always going to be an uphill battle getting 140 countries to agree on an international agreement that stands on complete economic principles because every country, every country has different preferences that fit their needs, their wants, their politics, and economic agenda.

Should we abandon all hopes of finding a solution to eradicate novel discriminatory taxes around the world? I would say no. But I have a deep concern with the treaty as it is presented at the OECD currently.

Mr. Bunn, the draft treaty lists nine DSTs and similar discriminatory measures that are subject to be replaced by Pillar 1. The rules are written in a way that countries can adopt Pillar 1 or capitalize on their redistributed tax revenues or have the option to keep their DSTs in place. I find this leniency to be problematic since the overreaching goal is to find compromise for all DSTs and discriminatory taxes are eliminated.

Does the draft treaty, as written, lead you to believe that all DSTs will be removed, and is there a door number two, so to speak, for new discriminatory tax measures to be implemented in the future?

Mr. BUNN. Thank you for the question.

No, I do not think the draft treaty would eliminate all discriminatory taxes. And, yes, I do think that it leaves open the possibility for new either mutated forms or proliferated forms of digital services taxes.

Mr. HERN. And I do agree with Ms. Funkhouser that we do need to stay at the table and that we figure out what is going on, because if you are not at the table, you are on the menu, as the old saying goes. And so we are the ones that are the targets of these DSTs, primarily, and we have to have a way to figure these out as opposed to creating a trade war.

Mr. Bunn, also under a formulaic system such as Amount A, the formula can be manipulated. Is there also concern that governments can modify their current DST to work around the current definition?

Mr. BUNN. Yes. You could apply your DST to foreign and domestic businesses and potentially use that as an escape route to be able to maintain a DST, and I think that could be the route that some countries that are looking at this deal would take.

Mr. HERN. Thank you.

Mr. Minor, we have already heard that some countries such as Australia will likely opt out of using Amount B construct set aside by the OECD last month, opting instead to use their existing transfer pricing mechanisms. How does optionality like this undermine the certainty and stability that has long been the primary goal of this policy?

Mr. MINOR. Yeah. Well, it is very problematic, and we don't— we are not very happy about that because that kind of sends a signal to other members of the Inclusive Framework that, you know, that may be an option for whatever purpose.

So an action like that unfortunately significantly undermines the Pillar 1 principles, and we were surprised to see that happen, actually. But there is no guarantee that other countries might want to go that route. But it does undermine the principles of the Pillar 1 solution.

Mr. HERN. I think it is worth noting—Mr. Chairman, if I may have just 30 seconds—that there is a group of us went to the OECD back in August, and it is a different conversation when you meet eye-to-eye with somebody versus sending text messages back and forth or, you know, certified letters, emails.

And what is interesting with the OECD, and I brought this up to our leader of the OECD, who is a former consultant with one of our large tax or large consulting groups in the United States, and my point to her was that, I know that you know how important Tax Code is to making strategic decisions in companies, not just in the United States but around the world, and so this is not any different.

Based on how we term and work this out and the United States' involvement will change—possibly change how companies do business around the world, and we need not give up our tax dollars in search of a solution to move around the world when we have done the right thing with GILTI and FDII to make sure that we fix it. Is it perfect? No, it is not. But we have got to do the right thing and make sure that we keep our companies safe here, create jobs here, put Americans to work here, and collect appropriate taxes here.

I thank you all so much.

Chairman KELLY. Mr. Larson, you are recognized for 5 minutes.

Mr. LARSON. Thank you, Mr. Chairman. And I want to thank all our witnesses as well.

And I want to continue along the line of my colleague, Mr. Doggett, and say that I think, especially as we sit up here and ask our experts questions, that it seems to us that stability is optimal in this situation and that we want to make sure as well that stability, certainty, and avoiding chaos—the chaos that will obviously come from any kind of trade war that would ensue because we haven't remained at the table and focused on working this through.

So we cannot allow our American innovation that is fundamental to the fabric of our country to be curtailed or punished by unilateral taxation from dozens of other countries. I think we are all in agreement on that.

But I have a process question. And, Mr. Bunn, I am going to direct it to you, but anyone can feel free to jump in as well. But the way it has been explained to me at least, that Amount A will be delivered through a Multilateral Convention, or MLC, I guess, as it is called, which would first be signed by the Treasury Department, then similar to our bilateral tax treaties, be ratified by Congress.

Is that correct, Mr. Bunn?

Mr. BUNN. Ratified by the Senate.

Mr. LARSON. Yes. So can you please explain the role of the House in this process and the role of the Senate as you see it?

Mr. BUNN. So thank you for the question. So the Senate would have to ratify the treaty with two-thirds majority. The Senate has not been—does not have a great reputation for acting quickly on tax treaties, does not have——

Mr. LARSON. Or any other legislation in the House either for that matter, but——

Mr. BUNN. I walked into that one. The other piece of this—and others on the panel may elaborate—would be implementing legislation. So there is part of this agreement that is us giving up our taxing right, but there is also legislative changes that would have to be done for us to claim the new taxing right.

Mr. LARSON. Mr. Sprague.

Mr. SPRAGUE. Yeah. No, I agree with that. For us to tax inbound Amount A, we need to change our so-called effectively connected income rules to give us tax nexus over the other countries' allocation of Amount A to the United States.

So the House, as the body responsible for originating tax legislation, would be in charge of that revision. And also, in terms of, you know, ratifying the treaty, I would think the expertise in the House, you know, there is plenty of reason for you to be thinking carefully about these issues and, you know, giving your advice to the Senate.

Mr. LARSON. Mr. Minor.

Mr. MINOR. Yeah. I would just echo that sentiment about the importance of the House and this committee specifically being very engaged on the development of the MLC, the next step, including

Amount B, and also considering what type of legislative changes would be necessary to possibly implement the MLC.

Mr. LARSON. Thank you. Ms. Funkhouser.

Ms. FUNKHOUSER. Yes. And I appreciate the question and believe that it is very important that the House, and particularly the subcommittee, is having this conversation, because it has to do, at the end of the day, with U.S. competitiveness and how companies invested in the United States are able to engage with customers, consumers around the world.

And so, therefore, I am very glad we are having this conversation today and see that as an important role of the subcommittee.

Mr. LARSON. Do you ever sit here and wonder as witnesses what you would do in our role? Is there anything specific that you would say, I don't understand why Congress just doesn't do—fill in the blank. We will start with you, Ms. Funkhouser.

Ms. FUNKHOUSER. I will say at this immediate moment, I actually don't have something in mind because I have been very focused on this hearing, but I do look forward to staying in touch as we work forward in this process.

Mr. LARSON. Mr. Minor.

Mr. MINOR. I think starting off with this hearing is a good idea, and I would like to continue a dialogue between, you know, this committee and also the business community on a regular basis.

Mr. LARSON. Because of the complication of the issue?

Mr. MINOR. Yes.

Mr. LARSON. Mr. Sprague.

Mr. SPRAGUE. I guess I would encourage Treasury to keep engaged and try to work as hard as they can to get a deal that is good for America.

Mr. LARSON. Mr. Bunn.

Mr. BUNN. I think one of the things that could be helpful is some sort of trade promotion authority in the tax area, specifically where Congress lays out priorities before the negotiations even begin.

Mr. LARSON. I like that. Thank you, all. I yield back. Thank you for the——

Chairman KELLY. That is fine. You are going to have a couple of weeks. You will be able to talk to—the Secretary of Treasury will be here. It is really—I think it is encouraging the fact—that is why we are here today. So thank you all for being here.

Dr. Ferguson, you are recognized for 5 minutes.

Mr. FERGUSON. Thank you, Mr. Chair. And, to the witnesses, thank you for being here. I must say, your answers regarding what Congress should be doing are much more kind than what I get out of my district most of the time, so thank you for your genteel responses.

Ms. Funkhouser, let me start with a question to you. When we are looking at this proposal—this is a digital services tax, okay? So we are talking about taxing the services in the digital arena. So much of that is based on data and the value of data.

Do you ever wonder then, given the fact that the U.S. has the highest quality data and the most tradable data in the world, does this open up—do you think that this avenue would open up problems with other countries taxing the value of our data? Not the services, but the value of the data. Do you see that as a concern?

Ms. FUNKHOUSER. Thank you for the question, Dr. Ferguson. And, I will say, we have applauded the efforts of this committee, as well as the administration, when it comes to extending the World Trade Organization's moratorium on Customs duties on electronic transmissions because this does get to some of what you are talking about when it comes to how companies are able to engage abroad and stay competitive.

And so we see maintaining the moratorium on customs duties on electronic transmissions as critical to maintaining U.S. competitiveness.

Mr. FERGUSON. Thank you. Mr. Bunn, when we look at the JCT score of this, I mean, their range is, like, a billion 4 to 400 billion, right? I mean, do you think that it is responsible to be moving in this direction without more complete data and understanding exactly the impact that this would have?

Mr. BUNN. Thank you for the question. So, if you read through the JCT analysis, one word that pops up regularly is "uncertainty." There is not, in my view, a point at which we will have much more certainty on those sorts of numbers than now, and that range, 100 million to, you know, 4.4 billion, that is a meaningful range. And, again, it is a single-year estimate, not a 10-year estimate, like JCT is normally able to provide.

But there is just so much complexity in the policy itself that this is not, like, you know, changing the corporate tax rate and JCT being able to do that in their sleep. This is a very difficult and complex policy that makes it hard to estimate.

Mr. FERGUSON. So advancing without the rules being written and understood seems pretty irresponsible to me at this point.

Mr. BUNN. I agree. And one of the things that is uncertain is how companies—the data that the companies themselves would use to comply with this is not all, sort of, in one place or clearly available for analysis.

Mr. FERGUSON. Okay. This question will be for whoever who can answer it, and we will just kind of point as we go along here.

Do you think that there is a situation where the money—the taxes levied here could wind up going to China at any level? Mr. Bunn, I will start with you.

Mr. BUNN. Yes. The allocation——

Mr. FERGUSON. That is fine. Mr. Sprague.

Mr. SPRAGUE. I haven't seen statistics, but if China is a net beneficiary of Amount A, then they would be able to tax the net Amount A transfer, but I have not seen any statistics on this.

Mr. FERGUSON. Mr. Minor.

Mr. SPRAGUE. Dr. Ferguson, could I respond to your taxing data question?

Mr. FERGUSON. Sure. Well, I tell you what, real quickly let me get through this so we have got enough time. Mr. Minor.

Mr. MINOR. Yeah. I haven't looked at that issue.

Mr. FERGUSON. Ms. Funkhouser.

Ms. FUNKHOUSER. No, I do not have statistics on that.

Mr. FERGUSON. Mr. Sprague, back to you for just a quick response on the data tax.

Mr. SPRAGUE. Taxing data, yeah. It is a very interesting question, and the original DSTs actually tax the transfer of data.

So one of the advantages of getting rid of the DSTs is to take away that tax that exists today in the DST countries on transfers of data. And keep in mind that the EC not too long ago proposed a general tax on data transfers.

The tax world is in a very unstable place at the moment with ideas like the EC data tax, the DST, you know, withholding tax on digital services. So, to the extent that the system can be stabilized to get rid of all of those departures from international taxation norms, that, I think, is what would be good for U.S. business.

Mr. FERGUSON. Okay. Thank you for those comments. I will say this: We should not be considering or supporting any legislation that allows $1 of U.S. taxpayer money to go to the Chinese Communist Party.

With that, Mr. Chairman, I yield back.

Chairman KELLY. Very good. Ms. Sánchez, you are recognized for 5 minutes.

Ms. SÁNCHEZ. Thank you, Mr. Chairman. I want to thank our witnesses for being here today. I have to confess, I am not a tax attorney. I am an attorney, and so trying to wrap my head around Pillar 1 sometimes is like trying to wrap my head around the rule against perpetuity, which takes a while until you are familiar with it.

So today we have heard some concerns about Pillar 1, but we also heard some suggestions for how we could improve it. And while some of my Republican colleagues are pulling the fire alarm, I just want us all to remember that these negotiations have spanned more than one administration, and, in fact, most of the initial work on Pillar 1 happened under the Trump administration.

But it is also important to keep in context the overall picture of Pillar 1 and what we were trying to do in terms of tax policy. And, essentially, American negotiators were trying to stop a trade war. They were defending American businesses who were openly targeted by other countries' digital service taxes, and U.S. negotiators have focused on trying to secure certainty for American companies. That is a theme that I hear over and over from business. Certainty, stability, clarity are all important.

So, surely, I think we all agree that we should protect American businesses against increasingly aggressive and confiscatory audits of their transfer pricing. And I think we should be focused in on how we can refine Pillar 1 to best protect U.S. interests without, again, forgetting why we entered these negotiations in the first place.

Ms. Funkhouser, your industry is probably most directly targeted by DSTs. Can you describe what you think will happen if Pillar 1 fails?

Ms. FUNKHOUSER. Thank you for the question, and I think it is a critical question to keep in mind as we are considering this. And I think, in the absence of a multilateral consensus-based solution, we will see further proliferation of unilateral uncoordinated taxes that are imposed on gross revenues and are targeted to either a specific subset of companies, as we have seen in some of the DSTs to date with U.S. companies, or nonresident companies altogether. And so, that would have a devastating effect on the international tax-and-trade environment.

Ms. SÁNCHEZ. And based on your experience following DSTs, do you think that aggressive taxes being pushed by other countries will stop at digital service taxes, or do you think that other countries will continue to try to find new and different ways to target U.S. companies?

Ms. FUNKHOUSER. We have already seen an increase in novel approaches, if you will, to taxation. I think the first generation of DSTs was focused on, like I—digital advertising, user data, et cetera. The next ones went to effectively anything that happens over the internet, as we see in India's equalization levy.

And then we have also seen changes, like the Australian Taxation Office's revised software payments ruling, which is looking at a new way of diverting from long-standing international tax norms.

Ms. SÁNCHEZ. So, although we have heard concerns today about Pillar 1 and we have heard, obviously, some suggestions from our panelists about how we can improve and refine it within the parameters of how it currently exists—and I think my colleague, Mr. Doggett said, you know, "What happens if the United States say, well, we don't like Pillar 1," we are just going to walk away from it, you know, does it really behoove us to stick our heads in the sand and hope that the problem of digital service taxes and other new problematic taxes by other countries are simply going to go away?

Any of the panelists care to comment on that, that we should just walk away, blow it up, walk away?

Ms. FUNKHOUSER. No. I strongly support continued engagement by the U.S. Government. Because, again, without strong engagement from the U.S. Government, we cannot make this a better Pillar 1 deal for the U.S. economy and for U.S. competitiveness.

Ms. SÁNCHEZ. Anybody else care to chime in?

Mr. SPRAGUE. Yeah, I will. The DSTs aren't going to just go away if Amount A or some other similar agreement is not negotiated and agreed to. I think the countries have made that pretty clear.

Ms. SÁNCHEZ. Mr. Bunn.

Mr. BUNN. I would agree. The challenge here is to get an agreement that fits the priorities of this committee, this Congress, and that is—I don't think that is the current draft, but to continue working towards that.

Ms. SÁNCHEZ. So it is worth it to roll up our sleeves, try to do the hard work, figure out what—you know, negotiations are based on compromise as well, but—what is the best deal that we can get and how can we best try to protect U.S. companies, U.S. innovation by sticking with the confines of Pillar 1. Yes?

Mr. MINOR. Yes, that is correct.

Ms. SÁNCHEZ. All right. I appreciate our panelists, and I yield back.

Chairman KELLY. Mr. Estes, you are recognized for 5 minutes.

Mr. ESTES. Well, thank you, Mr. Chairman, and thank you to our panelists today.

You know, I have been concerned about the proliferation of the discriminatory digital services taxes since I came into office in

2017, which is why I encouraged the previous administration to engage with OECD BEPS 2.0 project, which turned into the two-pillar process that we see today. The goals of this project were to eliminate DSTs, provide tax certainty, and simplification for businesses in the growing digital economy. And that is where the negotiations were going before the Biden administration came in and changed the direction.

I have been in ardent opposition to Pillar 2, the global minimum tax, especially the UTPR provision. I was hopeful that Pillar 1 would fulfill the stated goals of the original project. Unfortunately, what we are seeing is that more countries, like Canada, are enacting DSTs and the OECD issued a convoluted 800-page deal, quote-unquote, that leaves more questions than answers.

Because of this, it is my belief that this still now represents a foot in the door for more extraterritorial taxes on successful businesses, and that it is a deal that is out there, but it is not necessarily that we should accept a bad deal.

Additionally, the deal doesn't consider how businesses actually operate in the real world. Pillar 1's marketing and distribution safe harbor fails to adequately account for taxes paid in market jurisdictions under franchise or split ownership structures. This would force U.S. companies to overallocate profits to market jurisdictions resulting in more tax paid to foreign governments and less tax paid to the United States.

As with the Biden Treasury Department's failure to grandfather guilty and failure to protect U.S. research and development incentives, the administration is, once again, failing to protect U.S. taxpayers and U.S. tax collections. I have heard from one U.S. Fortune 200 company that the failure to properly protect franchise or split ownership structures would result in an annual reallocation for that one company of $500 million to up to $1 billion of U.S. revenue to over 100 foreign countries with a significant share going to already wealthy countries, like Germany and Spain.

As my colleagues have noted, the recently released JCT report notes that a plurality of in-scope companies would be from the U.S., and 70 percent or $135 billion of Amount A would be from American companies. Likewise, the U.S. Treasury would forgo between $100 million and $4.4 billion—depends on that large range of—per year of tax receipts, and while we are granting a new tax right to other countries.

It is my understanding that our Treasury Department is aware of the split ownership issue and has done nothing to fix it. Despite negotiating one of the most complex, confusing, and harmful deals that I have ever seen, the Biden administration claims that protecting our franchise and split ownership companies is just too complicated.

I am tired of hearing about this administration's hollow excuses. The massive reallocation of U.S. revenue is also not limited to U.S. companies operating in franchise or split-ownership structures. Another U.S. Fortune 200 company that is highly profitable in the United States would be forced to reallocate between $500 million and $1 billion of U.S. revenue annually to European and other foreign countries, even though these foreign countries have no economic nexus in the U.S. revenue. So for just two countries who are already up to almost $200 billion of U.S. revenue sent overseas.

Mr. Minor, do you have any views of the marketing and distribution safe harbor and Treasury's failure to protect our U.S.-based franchise and split-ownership structures?

Mr. MINOR. Thank you for the question. The two instances that you described have—are two of the issues that we have highlighted in our comments about making improvements to the marketing distribution safe harbor calculation, but we have a number of issues within DSH based on the modeling of our member companies that it does not seem to fully eliminate double taxation based on those calculations.

It is a unique formula. It is not related to the transfer pricing principles that are broadly adopted. So we also share your frustration that those two instances that you described have yet to be resolved. They may still be resolved.

I think the other one relates to the autonomous domestic business exemption, which does not apply to U.S. consolidated groups. And we think there are good arguments consistent with the principal of that exemption that should allow carve-outs under certain conditions. And we hope that those suggestions are still in play.

Mr. ESTES. Thank you. Mr. Chairman, the JCT report underlines my ongoing concerns with Pillar 1's current structure. As the House Ways and Means Tax Subcommittee, we should be firm in our commitment to putting the United States first, maintaining our tax sovereignty, and not giving in to global demand, and the JCT analysis confirms that Pillar 1, as currently negotiated by the Biden administration, does not accomplish the original goals set out when we began this exercise in 2018.

With that, I yield back.

Chairman KELLY. Thank you. Ms. DelBene, you are recognized for 5 minutes.

Ms. DELBENE. Thank you, Mr. Chairman, and thanks to all our witnesses for joining us today. I appreciate it.

I appreciate the opportunity to highlight the concerns around discriminatory digital services taxes and the need to ensure that a Pillar 1 deal protects American businesses and workers against a patchwork of unilateral DSTs. That only happens if the United States continues to hold strong on demands for improvements to the current multilateral convention.

Mr. Minor, if a critical number of countries were to sign and ratify the multilateral convention as it is drafted today, would that put an end to DSTs and relevant similar measures?

Mr. MINOR. Well, that would for those jurisdictions that sign on to the Amount A, with the caveat that we still have problems with the way the DST review in the current version of the MLC is drafted. And so, we have provided our advice on how to improve on that.

That does leave the issue of jurisdictions that decide not to sign up for the MLC. You know, under that situation, they are still free to pursue DSTs, but I am hopeful that there might be a trend then at that point against the proliferation of DSTs because I think the U.S. still has a number of options to go forward against those jurisdictions as it sees fit, if that is the case.

Ms. DELBENE. Thank you. A top Canadian finance department official recently said that Canada is advancing its plan to impose a digital services tax even though the U.S. is opposed, in part, because the U.S. has not retaliated against seven other countries, such as India, France, or Turkey, that have adopted DSTs. These countries' taxes were found by USTR to discriminate against American companies and workers. And, following the USTR investigations, the U.S. agreed to impose and then immediately suspend tariffs on these countries as part of a political agreement, which was recently extended through June of this year, focused on reaching a multilateral agreement at the OECD.

Ms. Funkhouser, what do you make of the contention that it is okay for Canada to impose a discriminatory tax because the U.S. has not yet retaliated against other countries with these taxes?

Ms. FUNKHOUSER. Thank you for the question, Representative DelBene. And thank you for all of your work with the Congressional Digital Trade Caucus to push back against DSTs, particularly the Canadian proposal.

I do not agree with the contention that it would be okay for the Canadian Government to move forward with this unilateral measure. On—one, it is modeled after the French DST. It is not identical, but it is very similar, which the USTR has found to discriminate against U.S. companies.

It also comes at a point in the multilateral negotiations that are trying to remove unilateral measures. And, if the Canadian Government moves forward, it could lead to perverse incentives to actually finalizing those multilateral negotiations.

Ms. DELBENE. So how do you think that impacts the OECD process. And so, you think Canada's actions will impact the OECD process?

Ms. FUNKHOUSER. Yes. I believe that if the Canadian government moves forward with DST, it could inspire similar actions from other governments, and then that would just increase the amount of perverse incentives you have when it comes to actually coming to a final compromise that provides for the reallocation of taxing rights and provides for the withdrawal of digital services taxes.

Ms. DELBENE. So their logic, if that holds, then anybody could say, we are going to go adopt a tax that discriminates against it because others are doing it?

Ms. FUNKHOUSER. Yes, exactly. And that is not an adequate reason to do so. These are inherently bad taxes in structure and scope.

Ms. DELBENE. Thank you. I appreciate it. I appreciate all of the feedback from everyone on the panel. Thank you.

I yield back, Mr. Chairman.

Chairman KELLY. Thank you. Mr. Smucker, you are recognized for 5 minutes.

Mr. SMUCKER. Thank you, Chairman Kelly, for holding today's timely hearing.

Before I move into questions, I just want to emphasize a few key points for my constituents back home who likely aren't following the OECD negotiations as closely as some of the tax community in Washington, but whose lives could be impacted by this.

I want to go back to the initial reason for the Pillar 1 discussions, as you have all said, were started with the intent of modernizing tax rules for the digital age. And the U.S. specifically entered into the discussions with the goal of reaching an agreement to remove discriminatory taxes, the DST taxes, on American companies, specifically American innovation, being enacted by several foreign allies.

But the Biden administration chose to leave Congress out of the negotiations, and what we are left with is a Pillar 1 deal that has failed to achieve its original and its fundamental purpose, eliminating harmful digital service taxes—referring to them as DSTs—that threaten American jobs and will likely send U.S. tax revenue overseas.

Because the Biden administration has chosen not to consult with Congress throughout those negotiations at OECD, I think today's hearing is an important opportunity to get the message out to the international community that Congress has serious concerns with Pillar 1. So I hope they are paying attention.

For this deal to move forward—and maybe I will ask Mr. Bunn to confirm this—this cannot move forward unless the Senate ratifies the treaty and unless my colleagues and I on the Ways and Means Committee will need to advance change to the U.S. Tax Code as well. Is that correct?

Mr. BUNN. Yes.

Mr. SMUCKER. So this doesn't get done unless we and the Senate agree with it as well. So it is important that folks are paying attention to that.

We believe endorsing a deal that penalizes American innovation that could cost American jobs and could end up sending tax revenue to foreign countries, even as some of you suggested here in answer to Mr. Ferguson's question, even nations like China that are askance simultaneously attempting to skew our innovation, we don't think that is in the best interest of our constituencies.

And let me ask the question maybe to Mr. Minor. Is there any scenario, in your estimation, in which this proposal does not reduce or undercut U.S. Federal revenue? Just keep in mind half of the taxable companies are U.S.-based. So this almost certainly will result in less revenue in the U.S. Do you agree with that?

Mr. MINOR. Well, thank you for the question. That is a tough one for me. I would have to defer to my colleague.

Mr. SMUCKER. Anyone else want to answer that?

Mr. BUNN. I think JCT's analysis with the uncertainties—even with the uncertainties, the range—all of those numbers are negative. It seems like——

Mr. SMUCKER. In other words, it would be a reduction?

Mr. BUNN. Reduction.

Mr. SMUCKER. Coming into the Federal—to the U.S.?

Mr. BUNN. Right. Even after accounting for additional revenues that could come from foreign companies, the net would be negative.

Mr. SMUCKER. Does that make sense to you? I mean, if we are even discussing reforming taxes surrounding U.S.-based businesses, shouldn't those taxes be used to benefit U.S. citizens and not people of other countries?

Mr. BUNN. I think one of the things—thank you for the question. I think one of the things inherent in this discussion is that tug and pull. Is this compromise, that reduction in U.S. tax revenue, worth it to get the certainty or the elimination of digital services taxes. And, if those are questionable, then the sacrifice, in my view, is not necessarily worth it.

Mr. SMUCKER. Ms. Funkhouser, would you like to respond to that as well?

Ms. FUNKHOUSER. Yes, I would. Daniel touched on this at the end. But part of this compromise in Pillar 1 is looking at bringing together a more predictable, certain, and stable tax environment. And so, the JCT report is part of the picture when it comes to considering how Congress chooses to engage with Pillar 1.

But I would highlight that companies are already paying digital services taxes, and for—they are impactful for all companies, regardless of profit margin, but particularly for those that are loss-making or low-margin companies. There are some jurisdictions out there that don't even have revenue thresholds. And so startups and small businesses are also directly affected by these gross revenue taxes.

So I would encourage Congress to keep that in mind when considering the compromise of Pillar 1.

Mr. SMUCKER. We also heard, some of you in answer to questions have said that this proposal will not eliminate all possible DSTs. So we could, essentially, have a situation where the Biden administration has negotiated an additional foreign tax proposal on U.S. multinational companies, while failing to eliminate the digital services tax.

Anybody want to respond to that?

Mr. SPRAGUE. I would like to respond to that. As Mr. Minor noted, the Amount A document actually lists the digital service taxes that are within scope, and would need to be withdrawn, and it includes all of the so-called first-wave DSTs; U.K., France, Spain, Italy, India, Turkey.

I would be very surprised if U.K., France, Spain, Italy did not sign on to Amount A. And so, I would be extremely confident that those DSTs would, indeed, be withdrawn. Canada—I would be surprised if Canada didn't sign on, in which case it would be precluded from asserting a DST.

Mr. SMUCKER. Do you think any country—I am sorry, I am out of time, Mr. Chairman.

But would you foresee any situation where countries would not sign on, where DST tax would stay in effect?

Mr. SPRAGUE. Maybe small countries. I mean, there are some very small countries with DSTs.

Mr. SMUCKER. Thank you. I am out of time. Appreciate that. Thank you so much.

Chairman KELLY. Good line of questioning.

Ms. Moore, you are recognized for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman. Let me start with you, Mr. Sprague. There has been a lot of discussion about the JCT estimates of revenues that would be lost, $1.4 billion.

Does consider the amount under B if it were mandatory? Would that mitigate the loss of revenue to the U.S.? Because I think one of the problems that I have been hearing is that, because Amount B is not mandatory, the transfer pricing, that that is part of the uncertainty.

Mr. SPRAGUE. Thanks, Congresswoman Moore, for the question. It is a pretty good question. There were a couple different points that I would like to respond to, first on Amount B.

I do believe that the introduction of Amount B, assuming it is adopted broadly, would be a net revenue raiser for the U.S. And the reason is that I do think that Amount B will tamp down some of these aggressive foreign transfer pricing adjustments, and that means fewer foreign taxes the U.S. companies claim as foreign tax credits and fewer correlative adjustments the U.S. companies would then claim in the U.S.

That is the—those are the two benefits of addressing, tamping down aggressive foreign adjustments.

We also need to think about the inbound side, right? Because Amount B, if the U.S. adopts it, would also be applicable to inbound distribution from overseas.

The IRS has just started a new project to look carefully at inbound distribution. My belief is that Amount B would not limit the IRS in its review of inbound distribution, and that project is likely to increase U.S. tax revenues.

So I think both on the outbound side and the inbound side, the introduction of Amount B would be a net tax revenue raiser for the U.S. I can't say how much. It is not going to be in the same magnitude as Amount A, but it will be a counterbalancing number.

The other element that I would like to emphasize is that the $1.4 billion is only one part of the whole. I think others, Ms. Funkhouser in particular, have mentioned that the deal is a deal that has lots of components. I mentioned that the international tax system today is in a very unstable state, and a lot of that instability, whether it is digital service taxes or withholding taxes on digital services, is directly impacting U.S. companies.

If the Amount A goals were achieved, we will restabilize the international tax environment, and that will be good for U.S. business. U.S. business is the most multinational of any business, any country. And restabilizing the international tax framework is going to allow U.S. business to operate overseas with more predictability and more stability than is the case right now.

Ms. MOORE. I got you. Let me ask Mr. Minor a question. We have heard a lot today about U.S. companies. The feedback we got in October was that they were concerned about the added complexity of complying with Amount A and then finding that they have very little tax liability.

How can these compliances, challenges, be mitigated? And again, is it worth it to go through the complexity of complying with Part A, and would it benefit the U.S. companies to do it, even if they have a limited amount of tax liability so that they can, in fact, get those receipts incoming and also mitigate problems that they would have with aggressive transfer pricing?

Mr. MINOR. Yeah. It is inherent in introducing a novel regime like Amount A that there is going to be significant compliance costs upfront, but there is a lot of money at stake.

So I guess on a proportionate basis, it is not an unusual ratio, the compliance cost to the amount at stake. And we have to remember, as Mr. Sprague just said, there are multiple components to the Pillar 1 project.

Ms. MOORE. Thank you. Ms. Funkhouser, why should ordinary people care about Pillar 1?

Ms. FUNKHOUSER. That is a great question. Ordinary people should care about Pillar 1 from the perspective of how does it contribute to U.S. competitiveness and engaging with the global economy.

Again, the U.S. economy benefits and contributes to the benefits problem, clearly the global economy, and that is why it is important for providing that stability, predictability, certainty that benefits U.S. companies and U.S. workers.

Ms. MOORE. Thank you so much for your indulgence, Mr. Chairman, and I yield back.

Chairman KELLY. Mr. Kustoff, you are recognized for 5 minutes.

We will go two-to-one now in the interest of time. I thank you all so much for being patient with us. Mr. Kustoff.

Mr. KUSTOFF. Thank you, Mr. Chairman, for convening today's hearing, and thank you to the witnesses for appearing as well.

Mr. Minor, if I can with you, the Pillar 1 multilateral convention will now require companies to file likely a substantial amount of sensitive financial information and tax information. In preparation for today's hearing, I was reviewing a letter submitted by the business roundtable. It is a comment letter to the Department of Treasury on the Pillar 1 MLC.

If I could, I wanted to read you part of it and then get your thoughts. This is from the letter dated December 11, 2023, from the business roundtable to the Department of Treasury. Regarding compliance, more information is needed as to the mechanics of filing returns, paying tax, and perhaps more importantly, the confidentiality of taxpayer information.

The level of detail and the data required for calculation under the MLC is greater than under typical tax compliance rules. For that reason, there should be extra sensitivity to what is shared for Pillar 1 purposes.

That is from the letter. So my question to you is, given the type and amount of information that companies have to report under the MLC, are there any concerns or legitimate concerns about confidentiality risks?

Mr. MINOR. Yeah. I guess the—that is a very valid risk, and that—what you just read out loud was—sounded very similar to the language in our consultation letter on that topic. Because of the—again, it is a novel regime. It is a multilateral regime.

And so, the dispute prevention and dispute resolution provisions are very detailed, very important. And one of our concerns was making sure that confidential information was only going to be shared with those jurisdictions who had a stake in any of that type of resolution review.

So we are going to continue to emphasize this issue. But, again, I think it is a reasonable concern to have, and we can't over-highlight that concern.

Mr. KUSTOFF. If I could—and I appreciate that. The letter goes on to say that stronger rules need to be in place where there are breaches of confidentiality since there is such a wide variation in the protections provided among parties and their domestic law. Given the more sensitive nature of the data that would be incorporated into calculations under the MLC.

So what mechanisms, if any, if you will, does the MLC include or need to include to address breaches of confidentiality?

Mr. MINOR. Yeah. Well, there need to be strong—you know, strong and clear consequences for breaches of any confidentiality, also as a deterrent, but as an enforcement mechanism.

Mr. KUSTOFF. Thank you very much. Mr. Bunn, can you speak about why Pillar 1 will likely result in revenue lost to the United States?

Mr. BUNN. Thank you for the question. As I have mentioned before, the analysis from the joint committee notes the uncertainties, but I will describe a situation in which these numbers hopefully make a little bit of sense.

A lot of high-value activity for U.S. multinationals happens in the U.S., and those profits are booked in the U.S. and taxed by the U.S. Treasury. The way the Amount A rules work, that if you have very high profit margins, 25 percent of profits over a 10 percent threshold could be subject to reallocation.

So the U.S., as home to very innovative and highly profitable businesses and where a lot of those profits are booked, will have an outside share available for reallocation. Part of the reallocation is to where customers are.

Now, the U.S. is about 30 percent of worldwide consumption. So a lot of consumption happens outside the U.S. A lot of customers for U.S. businesses are outside the U.S.

So you could see just from that kind of simple example that a lot of the profits available for reallocation could end up outside the U.S. Now, the U.S. would also get some inward reallocation, and the inward reallocation could come from U.S. businesses that have foreign operations, and they sell back into the U.S. market. And it could also come from foreign businesses that are selling into the U.S. market.

But, on net, the joint committee's analysis shows that it would be a net revenue loss, particularly looking at 2021 data.

Mr. KUSTOFF. Thank you, Mr. Bunn. Thank you, Mr. Chairman.

Chairman KELLY. Mr. Feenstra, you are recognized for 5 minutes.

Mr. FEENSTRA. Thank you, Mr. Chair. Thank you to each of the witnesses today. It is great to hear from you. I am trying to understand whether there is any coherence between the steps this administration is taking in this sector.

We started negotiating Pillar 1, for a large part, in response to the implementation of digital service taxes around the world, but more broadly, to adapt international taxation to the digital economy.

One of the advantages of doing Pillar 1, if at all, is that it would enable a paper reallocation of profits, not a physical one that is transferring economic activity, investment, and R&D to market jurisdictions. We want to keep all of this here in the United States.

But the abandonment of the moratorium of the digital trade by the Biden administration, meaning by allowing local data storage requirements to proliferate, essentially, creates a physical presence requirement in the market jurisdictions.

So, on one hand, at the OECD we are negotiating for a paper reallocation of profits. On the other hand, at the WTO we are negotiating a physical reallocation of profits. Though that is not the intent, it ultimately is the effect.

So what I am asking, Ms. Funkhouser, I am trying to reconcile these two seemingly contrasting objectives. Can you explain how the abandonment of the digital trade moratorium at the WTO, particularly the potential for the new local data storage, interferes with the goals of Pillar 1? Do you understand what I am saying?

Ms. FUNKHOUSER. Yes, I do, Mr. Feenstra. Thank you for the question. I appreciate it.

And, as you mentioned in October, the Biden administration withdrew support for some long-standing priorities in the World Trade Organization's plurilateral agreement on e-commerce, and these were priorities to prohibit data localization measures. And what this means, though, is that if a—if there are no commitments against data localization, a government can then require that if the company wants to serve that market, then that company would have to actually set up physical presence in the market, which would then lead to permanent establishment and lead to a taxing presence.

And so, that would mean, though, that if a company can no longer do that same activity in the U.S., it has to then do it in market to serve the market. You then lose the opportunity. And so, yes, we are very disappointed in the direction of digital trade policy and really encourage a priority that puts forward U.S. competitiveness.

Mr. FEENSTRA. So can you just explain, how does that create a disadvantage for American multinational or American companies?

Ms. FUNKHOUSER. It means that if a company wants to do business in the market, then it actually has to physically go into that market and is not able to have those jobs and that activity in the United States.

Mr. FEENSTRA. Thank you. And that can be very significant.

Ms. FUNKHOUSER. Yes.

Mr. FEENSTRA. And so I'm going to switch subjects now. I also look at what other countries are aggressively doing. They are shifting their tax burden on U.S. companies and are trying to find places where they can grab more dollars. We saw this in Europe, obviously, Germany's extraterritorial tax on Section 49, and similarly, is targeting our U.S. firms for the sole purpose of raising revenue.

We are seeing this also—Australia has designed its own tax targeted at U.S. software companies, and India is also frivolous in forcing U.S. companies in lots of litigation. What I am trying to get at is this:

Would you agree, Ms. Funkhouser, that American companies are typically targeted by foreign tax collectors, and do we see this proliferating—obviously, we are talking about Pillar 1, but we are also talking about a lot of different aspects. How do we, as Congress, answer that, and what can we do as a country?

Ms. FUNKHOUSER. Thank you very much. And you have really listed through the different ways that are is uncertainty in the international tax environment now. And perhaps as a first point, just thank you so much for your leadership in leading letters and making clear your concerns about the imposition of Section 49 in particular on the U.S. taxpayers.

I think that is a big part of making clear that the U.S. economy and U.S. competitiveness, though, should not be faced with extraterritorial measures. And so, thank you for the leadership you have shown in that regard.

Mr. FEENSTRA. Well, thank you. To me, this is very concerning, and I worry about this administration. It just seems like they are allowing this to occur. And this is very, very—we all can be aware of what is happening. We are losing our revenue, and the revenue is going somewhere else.

So with that, I yield back. Thank you.

Chairman KELLY. Thank you. Mr. Schneider, you are recognized for 5 minutes.

Mr. SCHNEIDER. Thank you, Mr. Chairman. I want to thank the witnesses for sharing their perspectives on what is relatively a very clear and simple concept to understand. So thank you for that.

One thing that I know from my years in business before coming to Congress is that two things that drive costs up are uncertainty and complexity. We are certainly talking here about a situation with great uncertainty and great complexity and the goal is to try to reduce that.

Mr. Sprague, you used the term earlier, the international tax system is unstable or incredibly unstable. Very briefly—because I want to touch on some other things—but what are the key implications of that instability in our focus, American multinational corporations?

Mr. SPRAGUE. Well, Mr. Feenstra's reference to the Section 49 tax is a perfect example. I mean, that was an opportunistic effort by Germany to tax the profits of U.S. multinationals.

The cost to U.S. business of the uncertainty is the cost—the tax cost of the special taxes, like Section 49 and DSTs, plus the expense of trying to plan a business when you don't have great visibility into what your tax liabilities are going to be.

That is another advantage of Amount B, trying to bring into a more narrow range, which a range of tax exposures is going to be, and distribution activity in foreign countries.

Mr. SCHNEIDER. Thank you. I am going to quote Ms. Funkhouser. You said in your opening remarks, absent robust U.S. engagement, including that of Congress—I will emphasize, Congress should be all caps and underlined because we have to be involved—there is little chance of resolving outstanding issues and crafting a final package that provides certainty and predictability for the global technology and you can expand that to industry as a whole.

My question for you, because we are talking about certainty and unpredictability, what is likely to happen if we walk away from the table for American technology companies?

Ms. FUNKHOUSER. Thank you very much for the question. Because it is something we spend time thinking about, and it really would be a further proliferation of unilateral uncoordinated taxes that are imposed on a gross revenue basis, and in some ways are attempting to reassess the digital economy and are really presenting trade barriers to the ways that companies invest in the United States are able to engage with other markets around the world.

And so you—the gross revenue base in particular is especially impactful for loss-making and low-margin companies. And so, as you are thinking about companies that are in the United States and looking to expand elsewhere, the proliferation of DSTs is especially harmful.

Mr. SCHNEIDER. Thank you. We need to move forward on this.

You also talked, Ms. Funkhouser, about the goal of Pillar 1 with predictability and uncertainty. The Biden administration is working to make Amount B as mandatory. Making sure it is for all countries is the way we achieve that certainty within Pillar 1.

Anyone disagree that it should be mandatory?

Ms. FUNKHOUSER. I believe it should be mandatory for governments to adopt Amount B and that companies should have an option when it comes to opting into Amount B and/or it should operate as a safe harbor. Again, if this is about simplifying transfer pricing, then that is how we would see it.

Mr. SCHNEIDER. Mr. Minor, anyone else?

Mr. MINOR. Yes, I agree. In my mind, mandatory is essential, and, you know, it should be seen as part of the overall deal for including Amount A as an important component of Pillar 1 and the elimination of DSTs.

Mr. SCHNEIDER. Mr. Sprague.

Mr. SPRAGUE. I agree with both of those comments, including that it should be a mandatory integral part of one that goes along with A.

Mr. SCHNEIDER. Mr. Bunn.

Mr. BUNN. I also agree that it should be mandatory.

Mr. SCHNEIDER. As my time is winding down, let me ask another question. I will just make it easier. Raise your hand if you think U.S. should stay at the table trying to achieve agreement on Pillar 1? We have got four out of four. Thank you. I appreciate that.

I will finish this one thing as we are coming to the end. My friend, Chairman Kelly, mentioned Atlas. There is often a misnomer of Atlas holding the world on his shoulders. It was actually the skies that Atlas held up. And Atlas was a Titan, was a giant.

I would like to—and this may be torturing the metaphor—view the United States as a titan of innovation, as a titan of creativity. We have talked 50 percent of the multinationals that are affected are U.S. companies. I am proud of the success and innovation and the progress that U.S. companies make.

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I want to make sure that whatever we do here ensures that those companies continue to be in the United States and that the sky is the limit for their potential.

With that, I yield back.

Chairman KELLY. Well said. I agree with you. It is also nice that this committee is actually getting involved in it and will continue down that road because this is so complex. It is very difficult. But I thank you all for doing that.

Mr. Smith.

Mr. SMITH. Thank you, Mr. Chairman, and to our ranking member for allowing me to waive on to the subcommittee here today. Appreciate the concerns so many have already expressed about the implementation of Pillar 1 and its impact on American businesses and innovations.

It is clear that both Pillar 1 and Pillar 2 are bad for American jobs and American workers and revenue to our Treasury. However, I am also here today because I am concerned that, in addition to the other problems discussed here, Pillar 1 will stop international efforts to—it will not stop international efforts to strip more revenue from American businesses operating abroad in the digital space, as has been discussed somewhat here today already.

Despite ongoing efforts with Pillar 1, Canada continues moving toward implementation, obviously, of its own DST, as was discussed, as do nations across Europe and around the world. Nations like Australia and Denmark, to name just two, also continue to pursue domestic content requirements for streaming services, placing even more demands on American businesses.

When policies like these are implemented by partners with whom the United States has trade agreements, they don't just undermine efforts to find a global standard, which Pillar 1 proponents say they are attempting to achieve. They also violate commitments made in trade agreements, like USMCA, and also the Australia/U.S. Free Trade Agreement.

We need an agreement which limits the ability of foreign governments to unfairly tax American companies, and we need it to do more than merely stop a single method among the many that foreign governments are using to target them. Pursuing targeted trade remedies should never be the first resort, but I fear that ongoing international efforts to implement DSTs and other requirements intended to directly target American companies could lead us there.

Mr. Bunn, in your opening statement you reflected on international implementation of DSTs and the potential effect of DSTs and other requirements in the trade space. Will Pillar 1, in its current form, put a stop to these efforts?

Mr. BUNN. In its current form, Pillar 1 identifies some DSTs that would likely go away once countries sign on to it, but that is not the full scope or the full universe of these discriminatory policies.

Mr. SMITH. And so, I mean——

Mr. BUNN. Some of them would likely remain, or there would be new mutations to get around the definitions within Pillar 1.

Mr. SMITH. And how would you propose moving forward to address some of these concerns?

Mr. BUNN. That is the challenge. If we remove ourselves from this negotiation, then there is less leverage to try to tighten the rules in the context of the negotiation. And you mentioned targeted trade remedies. I am not certain that those would be sufficient to change the policies of other countries without just an escalating trade war.

This is the real puzzle of the problem. You can increase the types of tools or increase the leverage that the U.S. might have in those negotiations and kind of see how it goes, but I don't think there is—there is a path outside of this multilateral negotiation that leads to more certainty on elimination of digital services taxes without some sort of trade war.

Mr. SMITH. Well, thank you. I think that these perspectives are important and that we continue to have this conversation. Obviously, we might have a separate trade subcommittee, but let's face it, trade policies from the Ways and Means Committee involve a lot of taxes and tax policies. So we might have separate subcommittees, but we definitely need to work together and to think and strategize together on behalf of American jobs and innovation and to apply ideas moving forward that will not shortchange us in the big picture.

So thank you again, Mr. Chairman. I yield back.

Chairman KELLY. Thank you. That is a great perspective coming from the chairman of the Trade Subcommittee.

Jimmy Gomez, 5 minutes.

Mr. GOMEZ. Thank you, Mr. Chairman. From the title of this hearing, at first glance, and some of my colleagues' testimony or statements, it seemed like my colleagues on the other side of the aisle were dead set on criticizing the Biden administration on just about anything, including Pillar 1.

Where the administration actually continues to actively fight for American interests by insisting on changes that will level the playing field for the U.S., there is actually a great deal of bipartisan agreement on the goals of Pillar 1. On Amount A, we agree that the U.S. should not be discriminated against with digital service taxes designed to target only American businesses and that the rules to enforce this must be uniform throughout all jurisdictions.

On Amount B, we agree that American companies and their subsidiaries should be able to operate across borders at arm's length in a stable, international tax system with wide scope, mandatory rules to ensure high certainty and low compliance cost. The administration has stated that they are for making Amount B mandatory and not optional, and there are—a lot of us agree with that.

When it comes to the cost of Pillar 1 or the effects on revenue, it is considered to be negligible. Some people would even say it is a rounding error. But it is a small price to pay for international tax certainty for American businesses.

There seems to be consensus on the principles of Pillar 1. So it is strange to me that, rather than supporting the Biden administration negotiating strategy of using our leverage to insist on provisions that level the playing field, critics on the other side of the aisle seem to prefer to tank a deal on Pillar 1 altogether.

But what is the alternative? Continued good-faith negotiations are the only thing preventing the worst outcomes. Sticking our heads in the sand and refusing to negotiate in good faith with the international framework will not make these challenges go away.

As more commerce moves online, countries with suspended digital service taxes will re-implement them. And, if we pull out of these negotiations with no alternative, other jurisdictions, like Canada and the EU, as a whole, will join them.

The previous administration threatened to escalate Trump's trade war by imposing retaliatory tariffs on key industries from countries that instituted digital service taxes.

Ms. Funkhouser, who pays the price for the higher tariffs of a trade war, and will those consequences be worse than continuing the Biden administration strategy of insisting on reasonable good faith improvements to Pillar 1?

Ms. FUNKHOUSER. Thank you very much for the question, Representative Gomez.

At the end of the day, global tax policy challenges require global tax policy solutions. That is why ITI has been so supportive of administrations—I mean, going back several administrations now, participating in good faith in those negotiations to secure a more predictable and certain international tax system.

So that is what is going to be the best outcome for U.S. competitiveness is an international—domestic and international tax environment in which companies have a certainty so that they can make investments, so that they can pursue R&D, so that they can engage with other markets.

Mr. GOMEZ. Mr. Sprague, do you see any viable alternatives to avoiding DSTs and trade wars other than the administration continuing in multilateral Pillar 1 negotiations, while insisting on commonsense changes like a mandatory Amount B?

Mr. SPRAGUE. I really think the continuing engagement on the Amount A concept is the only realistic way the DSTs will go away. If there isn't a treaty like Amount A, I would expect the existing DST taxing countries to retain them and other countries like Australia to impose them.

Mr. GOMEZ. Thank you. One thing I want to make clear is that Congress should be involved. But the administration has the correct position of negotiating, and people shouldn't assume negotiating is a sign of capitulation or weakness when it comes to American interests or putting America first.

I think it is the appropriate course of action, and if things do not work out, we always have other tools in the toolbox to address violations or discriminatory treatment of American companies.

With that, I yield back.

Chairman KELLY. Mrs. Miller, you are recognized for 5 minutes.

Mrs. MILLER. Thank you, Chairman Kelly and Ranking Member Schneider.

And thank you to all four of you witnesses for being here today.

I have been acutely concerned with the actions taken by the OECD and the Biden administration's failure to protect American interests over the course of the past several years.

I traveled to the OECD with Chairman Smith and my colleagues last summer to tell these unelected globalist bureaucrats that they are going down the wrong path, and the U.S. tax base is not a piggy bank for Europe socialist policies. These failed negotiations have left the United States in a much worse place than when President Trump started the process to protect our interests from the rising threats of the digital services taxes.

Biden's Treasury negotiators were either asleep at the wheel, or actively undermining U.S. companies, which will result in our tax dollars and jobs being sent overseas. Either way, this result is unacceptable. In the coming months, Treasury must do everything in its power to mitigate the damage that they have caused at the OECD.

The whole point of these negotiations was to protect U.S. companies from the digital service taxes, but France, Canada, and other countries have already moved forward, and the OECD process is unlikely to solve this issue.

As President Trump once wrote in "The Art of the Deal," the worst thing you can possibly do in a deal is to seem desperate to make it. This makes the other guy smell blood, and then you are dead. I urge President Biden to heed the advice of his predecessor and, hopefully, successor.

Mr. Bunn, can you go into further detail on why the U.S. is negotiating at the OECD on Pillar 1 and Pillar 2 in the first place?

Mr. BUNN. Thank you for the question. I think a little bit of the history of this is going to, I think, shed light on where we have come relative to where we were a few years ago.

So, after the passage of the Tax Cuts and Jobs Act, other countries looked at our policies like GILTI and said, "Well, maybe there can be a global agreement based off of this newly designed U.S. tax tool." We could call that a global minimum tax. And at the same time, with the digital services taxes that were being adopted, it looked like a decent path forward would be multilateral negotiation to eliminate those.

Back in 2019, Secretary Mnuchin sent a letter to the OECD that outlined concerns with the direction for Pillar 1 and suggested that maybe this should be an optional route for companies. And, in my view—this is my interpretation of the letter—is that if there was going to be a new multilateral agreement on allocating taxing rights, that the design of that should be attractive enough with certainty and stability and things of that—that companies may want to opt in to that.

And then, separately, the position of the Trump administration was to look at what was being negotiated on the global minimum tax and say, other countries, you are welcome to do that but as long as it doesn't implicate U.S. law and require U.S. law change.

Where we are today is we are—as we talk about Amount B, there are countries that are looking at Amount B and saying, "Well, we might want that to be optional." And on the global minimum tax side, the agreement has already eroded part of the U.S. tax base on GILTI. So that is where we have come from, or the journey we have been on over the last several years with these negotiations, and it is not clear that there is an opportunity to move back to that previous negotiating position.

Mrs. MILLER. Shame.

Mr. Minor, can you explain how the current definition of digital services taxes in Pillar 1 fail to meet the moment, and how could

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these definitions be improved in further negotiations to protect U.S. interests?

Mr. MINOR. Yeah. So, under the current language, there is some flexibility that an aggressive jurisdiction could simply see how the DST is defined and then draft its version of what I would then call DST that does not fall within the forbidden elements of the DST prohibited under the current draft of the MLC.

There is also an interesting exception for policy for imposing a DST in the current MLC, which looks like more of a political provision than, you know, a technical provision. And we have called for—there must be a more airtight version of the definition of DST to keep jurisdictions—prevent jurisdictions from being tempted to plan around what definition is in the MLC now.

Mrs. MILLER. Okay. One more quick question.

Would Pillar 1 be an easier way to comply within its current form, or would it make matters worse?

Mr. MINOR. Well, it is still being amended, and so, it is difficult to come to that conclusion until we have seen the final text of the MLC.

Mrs. MILLER. Okay.

Thank you, Mr. Chairman. I yield back.

Chairman KELLY. Thank you.

So Mr. Schneider and I were just talking back and forth here. This is the first time I have ever been in a hearing like this where nobody says, this is the Republican witness, this is the Democrat witness, as opposed to, these are all people who are concentrating on policy and not politics.

So I think if we start looking at our time here and what we are able to actually do—first of all, for the four of you to leave what you do every day to come here, God bless you. The only thing that is worse is having to come here every day.

But what we are talking about, this is so incredibly hard to understand. But for you to come and talk with us—and I think we will continue down this road.

The one thing that Mr. Schneider and I agree on: Congress has a role to play. My big concern always was from the beginning, when do we actually get involved? And I think, if you want to talk globally, the rest of the world looks at us and says, "When the United States get weak, somehow we get stronger, except, except when something tragic happens in the world." We are the first responder to every single thing that happens out there. So it is really incredibly important that we have a very strong economy.

I am going to fall off my stump here in a minute, but I mean this sincerely. Thank you all for taking the time, and thank you all for your expertise to come here. We sure appreciate it.

So, with that, the meeting is adjourned.

[Whereupon, at 4:56 p.m., the subcommittee was adjourned.]

MEMBER QUESTIONS FOR THE RECORD

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March 21, 2024

Question for Megan Funkhouser from Randy Feenstra

Question 1

In determining the revenue impact of Pillar One on the U.S. fisc and the impact of both Pillars on US companies, a big outstanding question is how exactly Pillar One interacts with Pillar Two. This is one of the points a few of you raised in your recent comment letters to Treasury, and it's ultimately going to play a significant role in determining the Effective Tax Rates for companies in both relieving jurisdictions and market jurisdictions, and consequently, the top-up taxes that are applied such as QDMTTs in relieving jurisdictions - and the related foreign tax credits for those QDMTTs. We know from the model rules commentary that Pillar One is intended to be applied, but exactly how that will work with regards to determining jurisdictional Pillar Two tax liability has yet to be clearly defined.

Ms. Funkhouser– *Can you discuss this point of concern further, and how the different possible variations on this interaction between Pillar One and Pillar Two can impact the taxes companies pay and the U.S. fisc?*

What approach to Pillar One and Pillar Two interaction do you think the Treasury Department should be pushing for?

Don't you think appropriate resolution of this issue is critical as Congress evaluates the overall impact of Pillar One?

Question 1

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Ms. Funkhouser– *Can you discuss this point of concern further, and how the different possible variations on this interaction between Pillar One and Pillar Two can impact the taxes companies pay and the U.S. fisc?*

What approach to Pillar One and Pillar Two interaction do you think the Treasury Department should be pushing for?

Don't you think appropriate resolution of this issue is critical as Congress evaluates the overall impact of Pillar One?

Response from Ms. Funkhouser:

The interaction between Pillar One and Pillar Two is a key open question for companies that pay taxes in the United States. As Representative Feenstra notes, the Commentary to the GloBE Rules makes clear the order and general treatment of the interaction between Pillar One and Pillar Two: Amount A under Pillar One applies before Pillar Two, and the Amount A taxes paid should be aligned with the related profits for purposes of calculating a taxpayer's effective tax rate under the GloBE Rules. However, there are some ambiguities within the overall structure.

ITI is seeking Congress and Treasury to advocate for further administrative guidance to make clear that Amount A does not create a deemed permanent establishment or constituent entity in the market jurisdiction, and that the taxes imposed on Amount A by market jurisdictions are covered taxes for the purposes of computing a taxpayer's effective tax rate under the GloBE Rules for the relief jurisdiction. This would align with the treatment of withholding taxes under the GloBE Rules. ITI encourages Congress and Treasury to secure this guidance so that companies do not face double taxation and Congress and Treasury can better determine the potential effects on the U.S. fisc as part of its consideration of the overall package.

With regard to the U.S. fisc, this approach would also mitigate the amount of qualified domestic minimum top-up taxes (QDMTTs) imposed by relief jurisdictions. Since QDMTTs are creditable against U.S. tax liability under the U.S. Global Intangible Low-taxed Income (GILTI) regime, taxpayers would have less exposure to the imposition of QDMTTs and therefore the United States would provide fewer foreign tax credits.

Where the U.S. is the relief jurisdiction, this approach could also reduce the impact of undertaxed profit rules (UTPRs) on U.S. income in the case of market jurisdictions with higher tax rates than the U.S. rate, because it would result in a higher U.S. effective tax rate as calculated under the GloBE Rules.

PUBLIC SUBMISSIONS FOR THE RECORD

ITI Promoting Innovation Worldwide

Comments on the draft OECD/G20 Inclusive Framework Pillar One Multilateral Convention Text

December 8, 2023

The Information Technology Industry Council (ITI) appreciates the opportunity to respond to the U.S. Department of the Treasury's request for public input on the draft OECD/G20 Inclusive Framework (IF) Multilateral Convention to Implement Amount A of Pillar One (MLC) and accompanying documents.[1]

The proliferation of digital services taxes (DSTs) and other problematic unilateral tax measures has destabilized the international tax system and led to challenges for all industries that do business across borders. As the IF has long maintained (and ITI agrees), it would not be feasible to ring-fence the digital economy for taxation purposes "because the digital economy is increasingly becoming the economy itself."[2] Global tax policy challenges require principles-based global tax policy solutions that engender stability, certainty, and predictability in the international tax system.

ITI views the IF as the best-positioned venue to address the tax challenges arising from the digitalization of the global economy, and ITI and its members are committed to supporting the IF's efforts to make for a multilateral, consensus-based solution to those challenges. Over the years, ITI has contributed to the IF's work by developing consultation responses to negotiators' questions and proposals, participating in public meetings, and publishing principles to guide negotiators as they undertake significant reforms to the international tax system. The draft MLC's release in October 2023 marked the first time that taxpayers and other stakeholders could review the draft package in its entirety; for that reason, the global technology industry greatly appreciates Treasury's holding a public consultation on the package.

In light of alternatives, ITI sees potential in the draft MLC for developing a multilateral, consensus-based framework to alleviate the negative consequences of the increasingly fragmented and controversy-heavy international tax environment. That is why ITI encourages Treasury to remain deeply engaged in the IF; absent strong U.S. participation, there is little chance of resolving outstanding issues and making for a final product that provides certainty and predictability for the global technology industry. For Pillar One to be

[1] The Information Technology Industry Council (ITI) is the premier global advocate for technology, representing the world's most innovative companies. Founded in 1916, ITI is an international trade association with a team of professionals on four continents. We promote public policies and industry standards that advance competition and innovation worldwide. Our diverse membership and expert staff provide policymakers the broadest perspective and thought leadership from technology, hardware, software, services, and related industries.

[2] OECD, "Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report," October 2015, 54.

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successful, U.S. Treasury and partners must also commit to supporting capacity building in participating tax administrations.

We put forward the following Pillar One-related priorities and objectives to guide Treasury's engagement in the IF and contribute to its future consideration of an MLC. The remainder of the comment identifies several implementation and administration issues in the MLC that would benefit from further consideration.

Key areas for Treasury to focus its attention include:

- **Improve and complete the MLC.** The comment goes into more detail, but ITI draws particular attention to achieving better balance between administrability and precision in the revenue sourcing rules, providing more double taxation relief through the marketing and distribution profits safe harbor (MDSH), clarifying that a measure can be a DST or relevant similar measure (RSM) if the scoping and/or burden of collections primarily falls on non-resident taxpayers, making clear that Significant Economic Presence (SEP) measures are not appropriate for any taxpayer, and strengthening Contracting Parties' commitment with respect to subnational taxes. ITI encourages the IF to further consider an enforcement mechanism to ensure the standstill and rollback of DSTs and RSMs occurs. We also note with concern the outstanding issues in the MDSH section, as these issues have significant bearing on the overall effectiveness of Amount A.

- **Extend the standstill.** ITI strongly supports extending the standstill on the imposition of DSTs and RSMs, as it provides for a more stable tax environment in the interim and reduces the risk of perverse incentives that may derail finalization of the project. U.S. Treasury should continue pushing for the IF to provide an explicit extension of the standstill through the earlier of December 31, 2025 (to provide sufficient time for the IF to achieve consensus on all material aspects of the MLC) or the coming into force of the MLC.

- **Dissuade the Canadian government from adopting a DST.** Despite significant milestones in the IF, the Canadian government continues to reiterate its interest in advancing a DST. ITI continues to call on U.S. Treasury and U.S. interagency partners to encourage the Canadian government to fully drop its consideration of a DST and respect its commitment to realizing a multilateral, consensus-based solution through the IF.

- **Finalize Amount B and commit to expanding initial scoping.** ITI continues to appreciate the U.S. emphasis on the need for a robust Amount B to fulfill the Pillar One package. Amount B has a critical role to play in securing tax certainty and facilitating a more predictable and stable international tax landscape, which is why the U.S. and other IF jurisdictions should finalize Amount B before the end of 2023.

ITI seeks a commitment from U.S. Treasury to exploring ways to expand Amount B's coverage, particularly for services and intangible goods and services.

- **Confirm the treatment of Pillar One taxation for the purposes of Pillar Two.** The Commentary to the Global Anti-Base Erosion (GloBE) Model Rules supports the application of Amount A before the GloBE Rules and the alignment of market jurisdiction tax with related GloBE Income but also foreshadows the development of further administrative guidance to address the treatment of Pillar One taxation.[3] U.S. Treasury should work with the IF to prioritize developing administrative guidance to make clear the treatment of Pillar One taxation for the purposes of Pillar Two.

Again, ITI appreciates the work that the U.S. Treasury and other IF participants have put forward and the opportunity to provide commentary on the draft comprehensive package.

Novel Issues Identified by a Review of the Comprehensive Text

Annex B – Calculation of Adjusted Profit Before Tax

The Elimination Profit (Annex B, Section 4.2) incorporates tax stock-based compensation (SBC) but the Adjusted Profit Before Tax (Annex B, Section 2.1) does not consider tax SBC. The MLC nor the Explanatory Statement (ES) provide an explanation for the discrepancy. ITI requests that the calculation of Adjusted Profits Before Tax be amended to include tax SBC so that it aligns with the calculation for Elimination Profit.

Implementation and Administrability Issues

Article 2 – General Definitions

Lower Income Jurisdiction. Article 2(dd) defines "Lower Income Jurisdiction" as a Jurisdiction that the World Bank identifies as a low-income economy or as a lower-middle-income economy as measured by gross national income per capita by the World Bank Atlas method. However, the World Bank does not assess all jurisdictions participating in the IF.[4] U.S. Treasury should seek guidance on ways to identify a Jurisdiction as a "Lower Income Jurisdiction" if that Jurisdiction has not been assessed by the World Bank Atlas method.

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[3] GloBE Model Rules Commentary on Article 4.2 at paragraph 29: "Tax on net income of a Constituent Entity under Pillar One would be treated as a Covered Tax under the GloBE Rules as a tax with respect to income or profits. Because Pillar One applies before the GloBE Rules, any income tax with respect to Pillar One adjustments will be taken into account by the Constituent Entity that takes into account the income associated with such Tax for purposes of calculating its GloBE Income or Loss."

[4] As of November 13, 2023, Jurisdictions participating in the IF but not represented in the World Bank's assessment of gross national income (GNI) per capita, Atlas method include Anguilla, British Virgin Islands, Cook Islands, Gibraltar, Jersey, and Montserrat.

Annex C – Supplementary Provisions for Article 3 (Covered Group)

Section 3 of Annex C would require Covered Groups subject to segmentation to calculate Amount A as a Segment in year 2 – rather than as a Covered Group in year 2, even if it meets the profit threshold for being in-scope as a Covered Group in year 2 – to the extent that (i) in year 1, the Segment meets the profit threshold but not the Covered Group; and (ii) the calculation of Amount A as a Segment in year 2 would result in additional Amount A reallocation than if computed for the entire Covered Group.

ITI recommends revising the MLC to disregard the segmentation approach in year 2 if the Covered Group is otherwise in scope of Amount A, as there is no policy basis for calculating Amount A on a segment basis if the Covered Group is in scope. If the provision remains, then there should be a corresponding provision that reduces the Amount A allocation for the year following that in which a Covered Group falls out of scope.

Article 5 – Allocation of Profit Associated with Revenues in the Market

Article 5.1(b) enables the application of the MDSH adjustment if the adjusted elimination profit (or loss) of the Covered Group in the Jurisdiction for the Period is greater than or equal to EUR 50 million. A Covered Group is considered as having nexus in a Jurisdiction for a Period if Adjusted Revenues arising in that Jurisdiction are equal to EUR 1 million or EUR 250 000 for a Jurisdiction with a Gross Domestic Product of less than EUR 40 billion. The considerable gap between the initiation of nexus and the application of the MDSH adjustment limits the effectiveness of the MDSH, as the MDSH will not be available in many jurisdictions and Covered Groups will bear a significant compliance burden. ITI suggests that the IF remove thresholds altogether for the application of the MDSH or, at a minimum, establish the same threshold for receiving an Amount A allocation and benefitting from MDSH, or apply a threshold for the MDSH that is more proportionate to the thresholds for nexus.

Article 5(d) establishes the conditions to determine the "jurisdictional offset percentage" in a Jurisdiction. The business community continues to view the "jurisdictional offset percentage" as undermining the effectiveness and guiding principles behind the MDSH and recommends that the jurisdictional offset percentage be eliminated or set at 100% in all cases. ITI further urges for Amount A to be adjusted for 100% of the Withholding Tax paid in the Jurisdiction.

ITI welcomes the inclusion of a mechanism to account for Withholding Tax(es) imposed by a Market Jurisdiction to reduce Amount A allocation to that Market Jurisdiction. However, the number of unresolved issues related to Withholding Taxes is concerning given the importance of double taxation relief. ITI also notes with concern there will be no adjustment for the first two years following implementation of the MLC, and that in following years the adjustment will fall to between 25% and 85% of the WHT suffered. A robust MDSH – which includes Withholding Taxes in a meaningful way – is critically important to a successful Amount A.

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Article 6 – Sources of Adjusted Revenue

ITI appreciates the IF's revisions to make the sourcing rules more administrable, particularly through clarifying the predominant character rules and setting the expectation that taxpayers rely on commercial and other available data rather than pursue novel reporting obligations. However, there are still scenarios where taxpayers may not have data for enumerated reliable indicators. ITI encourages the IF to produce principles and/or examples that demonstrate how taxpayers should navigate situations in the absence of enumerated reliable indicators. This would make for a smoother process for taxpayers who work with Advance Certainty Panels to devise compliance processes that reflect these principles and make use of available data.

Enterprise-application software. Article 7.1(d)(ix) prescribes that "not described" services are treated as arising in the Jurisdiction in which the service is used. This section attempts to apply a single source rule to significantly different fact patterns, some of which may benefit from greater clarity. In particular, the sourcing principle does not aid in identifying a reliable method to determine the appropriate Jurisdiction for revenues arising from the provision of enterprise-application software (EAS).

The MLC should clarify that EAS should be considered as used in the Jurisdiction of the direct purchasing entity, which for all intents and purposes is the user of the software or its final customer. EAS facilitates central business management functions and mission-critical operations for an organization, which allows the business to centrally manage organizational data from various sources to improve efficiency and productivity. The expense to purchase, maintain, and operate EAS is borne by the purchasing entity responsible for implementing the solutions. Similarly, the core advantages of the EAS principally benefit the direct purchasing entity. The revenue sourcing rules should reflect the realities of EAS by explicitly identifying the end-user or final customer of EAS as the purchasing entity which incurs the expense and the associated benefits. For this category, sourcing by billing address is appropriate to determine the Jurisdiction of use for both specified large customers (SLCs) and non-SLC customers. This approach would be consistent with treatment under current Treasury and IRS regulations.

Other Services (including cloud service providers). With regard to "specified large customer," ITI welcomes the removal of requirements for service providers to request additional data from its customers. The revised rules still present a challenge for cloud service providers due to the requirement for businesses to apply different allocation methods by customer type (Small Customers, Large Customers, and Resellers). For example, the imposition of three different sourcing rules will require Covered Groups to separate revenues between direct sellers (and differentiate by size) and resellers. Further complicating the task is that some direct customers are also resellers, which may make differentiating more difficult if not impossible.

ITI recommends instead that determining the top 200 Large Customers based on individual account numbers where no additional information is readily available, be considered a reasonable method. The MLC should also affirm that customers can use the same allocation key method for all three customer types where the relevant information to segregate by customer type is not readily available.

Using the headcount allocation for a Large Customer would require a taxpayer to segregate their customers into a subset of Large Customers and obtain customer-specific information on headquarter locations (which may not be public information), and then determine the appropriate allocation key. The subjective standard for a seller to satisfy reasonable efforts to demonstrate it does not have an undefined "client file" in its possession or has searched for "accessible" information sources creates uncertainty and undue burden.

Article 12 – Provision of Relief for Amount A Taxation to Relief Entities

As drafted, the MLC allows for significant flexibility in domestic laws that may yield double taxation. One example is the rules set a minimum of three years for credit carryforwards but do not articulate what happens if the relief is not achieved in three fiscal years. ITI recommends making credit carryforwards indefinite until the relief is achieved. Further, the IF should make clear that jurisdictions cannot deny other double tax relief as a result of relief being granted under the MLC.

Industry has consistently called for the exemption method as the only means of eliminating double taxation and maintains that position in the response to the MLC.

Article 21 – Currency Conversion Rules for Calculations and Liabilities

Article 21.3(b) provides a Party with the discretion to rebase local currency thresholds based on the average foreign exchange rate as quoted by the Party's central bank "if the Party faces legal or practical impediments" to using the foreign exchange reference rates quoted by the European Central Bank. This discretion presents the possibility of a dispute over thresholds. ITI suggests the development of a default rule governing conversion rate to address any potential disputes over thresholds resulting from the flexibility in Article 21.3(b) and provide greater certainty and clarity for taxpayers.

Article 22 – Requests for Certainty over Whether a Group is a Covered Group

Article 22.1 introduces a "tax certainty user fee" to accompany a Group's request for scope certainty for a Period.[5] Any such user fee should be reasonable and not unduly burdensome. The IF should also consider a mechanism to coordinate reviews in order to address several issues at once and minimize the imposition of the user fee on an issue-by-issue basis.

Article 27 – Determination Panel to Resolve Disagreements

The alternative outcomes provided to a determination panel should include the compliance approach identified by the Covered Group. ITI recommends amending Article 27.2 to ensure

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[5] Article 23.1 introduces a "tax certainty user fee" for the purpose of submitting a Covered Group's request for comprehensive certainty and a Covered Group's request for advance certainty. The comments on Article 22.1 apply equally to the applicable "tax certainty user fee" for comprehensive certainty and advance certainty.

the Covered Group's compliance approach receives consideration alongside the other alternative options.

Article 33 – Mutual Agreement Procedure

The MLC does not directly address tax certainty for issues related to Amount A in the absence of a covered tax agreement. To achieve greater stability for issues related to Amount A, ITI encourages the IF to adopt language in the MLC that directs covered jurisdictions and Covered Groups to follow transfer pricing guidelines (e.g., the OECD Transfer Pricing Guidelines) if a covered tax agreement is not in effect. This will be especially important for taxpayers that will not benefit from the limited scope of Amount B as currently drafted. Relatedly, ITI underscores again the importance of expanding Amount B to include services.

Article 35 – Resolution of Disputes with Respect to Related Issues

ITI welcomes the revisions to the provisions on mandatory dispute resolution, such as the expansion of "matters related to Amount A" to include Transfer Pricing, Permanent Establishment, and Withholding Tax disputes.

Article 37 – Exchange of Information and International Cooperation

The MLC requires significantly more data for calculations than is currently required for tax compliance and cautions against using data for "fishing [expeditions]." Given the greater level of detail and therefore heightened sensitivity, ITI recommends that U.S. Treasury advocate for more tangible guardrails around the use of "foreseeably relevant" as justification for sharing data, as well as advocate for establishing rules to address breaches of confidentiality. Participating jurisdictions have substantive variations in legal obligations for protecting taxpayers' information, so it would be useful to have an IF-wide understanding of the responsibilities arising from data related to Amount A compliance. Further, it is not clear why the MLC seems to consider "tax policy analysis" as a reasonable justification for sharing data; ITI recommends removing that justification.

Part VI – Treatment of Specific Measures Enacted by Parties

ITI strongly welcomes the removal of existing DSTs and RSMs and the development of criteria to prohibit the future imposition of such measures. The current draft includes significant improvements compared to the language previously published in December 2022.

The MLC does not include an enforcement mechanism for the standstill and rollback of DSTs and relevant similar measures. The carrot for withdrawing a DST is receiving Amount A taxing rights; however, there is no stick that recognizes the harmful effects of DSTs to the overall international tax and trade environment and encourages jurisdictions to roll back their DSTs. ITI encourages the IF to further consider an enforcement mechanism to ensure the standstill and rollback of DSTs and relevant similar measures takes place.

Article 38 – Removal of Digital Services Taxes and Relevant Similar Measures

ITI appreciates the IF's continued commitment to prohibiting the application of DSTs and RSMs to any person.

Article 39 – Elimination of Amount A Allocations for Parties Imposing Digital Services Taxes and Relevant Similar Measures

When determining whether a measure is a DST or RSM, Article 39.2(b)(ii)(A) establishes one factor as the presence of "revenue thresholds, exemptions for taxpayers subject to domestic corporate tax in that Party, or other scope restrictions that cause the measure to apply in practice **exclusively or almost exclusively** to non-resident or foreign-owned businesses" (emphasis ITI). The ES includes an example where "only a few percent of the taxpayers" were domestic taxpayers. While recognizing this is one example, ITI considers the current interpretation of "exclusively or almost exclusively" to be too narrow and strongly encourages the IF to clarify that a measure can be a DST or relevant similar measure if the scoping and/or burden of collections primarily falls on non-resident taxpayers. A small domestic incidence of an otherwise targeted tax should not absolve that Party of its commitments under Part VI of the MLC.

ITI also raises concern about Article 39.2(b)(ii)(B)'s standard of "[having] the effect of insulating domestic businesses from the application" and the accompanying statement that the evaluation of a measure will take into account the "policy objectives of the tax." The application of such a subjective test may enable the continued introduction of discriminatory measures under the guise of other "policy objectives" and yield the same destabilizing effects. ITI recommends either removing the third prong altogether or establishing guardrails to ensure that consideration of "policy objectives" does not become a carte blanche.

ES paragraph 918 makes clear that Amount A would be denied starting on or after the date of a decision by the Conference of the Parties, "and not retroactively." ITI firmly believes that Amount A should be denied from the date such a law takes effect. The imposition of a DST throughout the determination process creates contrary incentives because the negative consequences for the jurisdiction will be delayed but the DST will have an immediate effect on affected taxpayers. The MLC should require full repayment of the DST amounts; at a minimum, the DST liability should remain creditable against any Amount A owned to that Party.

The United States' existing transitional arrangements with several jurisdictions enable taxpayers to obtain a credit against Amount A liability for DSTs paid in the interim period. ITI suggests that the IF modify the MLC to incorporate a credit with respect to DSTs paid during the interim period and extend affected taxpayers the opportunity to obtain a credit against Amount A liability with respect to DSTs paid until the MLC takes effect and the third jurisdiction ceases to impose the DST.

Annex H – Review Process and Early Clarification on Digital Services Taxes and Relevant Similar Measures

Annex H of the MLC provides that if a subnational jurisdiction in a Party imposes a "subnational digital services tax or relevant similar measure," the Party in which the subnational entity is located must report to the Conference of the Parties within six months to "detail its efforts to achieve the removal of the measure." There is no denial of Amount A

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reallocation (or even a requirement for a Party to take any action) for a Party in which a subnational government imposes a DST or RSM. Absent a denial of Amount A reallocation, little stands in the way of a proliferation of subnational DSTs and RSMs that stand to disrupt the international tax system. ITI strongly encourages the IF to act to prevent the proliferation of subnational measures and alleviate the effect of any subnational measures.

Article 40 – Treatment of specific measures in scope of tax treaties

Article 40 would prevent Parties from applying certain measures in scope of tax treaties (e.g., SEP measures or similar concepts) to Group Entities of Covered Groups and that "[revenue] will not be included in the Elimination Profit (or Loss) of Amount A." ITI supports the non-imposition of SEP measures or similar concepts to Covered Groups but has concerns that the MLC may inadvertently imply that SEP measures or similar concepts are appropriate for MNEs that are not Covered Groups. The MLC or the Explanatory Statement should make clear that the IF does not endorse SEP measures or similar concepts, and that the IF firmly opposes the proliferation of such taxes.

ITI understands the SEP measures and similar concepts to sit outside of the Conference of the Parties' process for determining DSTs and RSMs. If a Party imposes a SEP measure or similar concept on a Covered Group, then the Covered Group only has recourse through that Party's domestic legal system. ITI urges the IF to consider establishing penalties for Parties that impose SEPs or similar concepts on Covered Groups.

Similar to DSTs and RSMs, SEP measures have a destabilizing effect on the international tax environment by imposing uncoordinated, gross revenue-based taxation and attempting to ring-fence the digitalizing economy. SEP measures or similar concepts establish corporate tax liability in a jurisdiction around the basis of sales and/or market engagement rather than permanent establishment, which conflicts with the international tax system's generally assigning taxing rights around the concept of permanent establishment. Governments are unlikely to provide a credit for any SEP tax paid, and companies can incur significant compliance costs in addition to payment of the tax itself. The approach is burdensome for all companies but is especially impactful for low-margin and loss-making companies; the structure also means that the burden of the tax frequently falls on in-country business-to-business and business-to-consumer sellers and consumers through price increases.

Conclusion

ITI thanks Treasury for its years of engagement and contributions across several administrations to the IF's efforts to address the tax challenges arising from the digitalization of the global economy. We stand ready to answer any questions you may have on the comment.

*****

U.S. Chamber of Commerce

1615 H Street, NW
Washington, DC 20062-2000
uschamber.com

March 21, 2024

The Honorable Mike Kelly	The Honorable Mike Thompson
Chairman	Ranking Member
Committee on Ways and Means	Committee on Ways and Means
Subcommittee on Tax Policy	Subcommittee on Tax Policy
U.S. House of Representatives	U.S. House of Representatives
Washington, D.C. 20515	Washington, D.C. 20515

Re: Tax Subcommittee Hearing: "OECD Pillar 1: Ensuring the Biden Administration Puts Americans First"

Dear Chairman Kelly and Ranking Member Thompson:

The U.S. Chamber of Commerce commends the Subcommittee on Tax Policy for conducting a hearing on Pillar One of the OECD/G20 Inclusive Framework's two-pillar solution to address the tax challenges arising from the digitalization of the economy. Last fall, the OECD released the draft text of a proposed Multilateral Convention to Implement Amount A of Pillar One ("Pillar One MLC") and two related documents. Amount A of Pillar One is intended to reallocate the taxing rights over certain profits the world's largest multinationals to market jurisdictions while requiring the removal and standstill of digital services taxes and other relevant similar measures. According to the OECD, the Pillar One MLC is designed to enhance stability and certainty in the international tax system by coordinating this reallocation of taxing rights with a corresponding obligation to relieve double taxation. As currently drafted, however, the Pillar One MLC would fail to achieve these critical policy objectives in several material respects and, therefore, warrants congressional scrutiny.

Please find enclosed for the hearing record our comment letter to the Department of the Treasury of December 11, 2023, which highlights some of our member companies' most acute, widespread concerns with the draft Pillar One MLC. Given the fundamental nature of these concerns, the Chamber would counsel the United States against signing any final Pillar One MLC that fails to meaningfully address them. Instead, we join you in calling on the Biden administration to redouble its efforts to negotiate—with robust congressional consultation—a better Pillar One deal for American businesses and workers.

Thank you for your continued leadership on this issue of critical importance to the competitiveness of U.S. companies and the integrity of our corporate tax base.

Sincerely,

Watson M. McLeish
Senior Vice President, Tax Policy
U.S. Chamber of Commerce

Enclosure

U.S. Chamber of Commerce

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December 11, 2023

The Honorable Lily L. Batchelder
Assistant Secretary (Tax Policy)
U.S. Department of the Treasury
1500 Pennsylvania Avenue N.W.
Washington, D.C. 20220

Re: Draft OECD/G20 Inclusive Framework Multilateral Convention to Implement Amount A of Pillar One

Dear Assistant Secretary Batchelder:

The U.S. Chamber of Commerce ("Chamber") welcomes the opportunity to comment on the draft text of the OECD/G20 Inclusive Framework's Multilateral Convention to Implement Amount A of Pillar One ("Pillar One MLC") and accompanying documents.[1] While certain pieces of the Pillar One MLC were previously the subjects of OECD public consultations, this is the first time that complete drafts of all three Pillar One documents have been made available to the public. We therefore appreciate the Department of the Treasury's ("Treasury") decision to open an official public consultation on these documents, which contemplate a radical change to the global international tax system.

Spanning nearly 900 pages, the draft Pillar One MLC documents would implement a critical component of the OECD/G20 Inclusive Framework's ambitious "two-pillar solution" to address the tax challenges arising from the digitalization of the economy. That component, Amount A of Pillar One, is intended to reallocate the international taxing rights over a portion of the profits of roughly 100 of the world's largest and most profitable multinational enterprises ("MNEs") to market jurisdictions while requiring the removal and standstill of digital services taxes ("DSTs") and other relevant similar measures. According to the OECD, the Pillar One MLC is designed to enhance stability and certainty in the international tax system by coordinating this reallocation of taxing rights with a corresponding obligation to relieve double

[1] On October 11, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting released the draft Pillar One MLC accompanied by an Explanatory Statement and the Understanding on the Application of Certainty of Amount A (collectively, the draft "Pillar One MLC documents"), available at https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.htm.

taxation.[2] As set forth below, however, the draft Pillar One MLC would fail to achieve these policy objectives in several material respects and, therefore, warrants further attention by Treasury. The following comments discuss several such aspects of the draft Pillar One MLC and provide pragmatic, consensus-based recommendations for addressing them, consistent with Pillar One's underlying policy aims.

Marketing and Distribution Profits Safe Harbour Adjustment

Under the so-called marketing and distribution profits safe harbour ("MDSH") adjustment, profit reallocated under Amount A of Pillar One would be adjusted downwards to prevent double taxation (or "double counting") in cases where a market jurisdiction could otherwise tax an MNE's excess profit twice—once under its domestic corporate tax/transfer pricing rules and again under Amount A. In laying the policy foundation for the MDSH adjustment in 2020, the OECD explained that:

> [i]t would not be a traditional safe harbour, but would instead "cap" the allocation of Amount A to market jurisdictions that already have taxing rights over a group's profits under existing tax rules. Conceptually, it would consider the income taxes payable in the market jurisdiction under existing taxing rights and Amount A together, and adjust the quantum of Amount A taxable in a market jurisdiction, on the basis of limiting it where the residual profit of the MNE group is already taxed in that jurisdiction as a result of the application of the existing profit allocation rules.[3]

By capping the profit reallocated to market jurisdictions under Amount A, as contemplated above, it is clear to see how such an adjustment would further the stated policy objective of avoiding double counting in cases where a market jurisdiction could otherwise tax an MNE's excess profit twice. As described in Article 5 of the draft Pillar One MLC, however, the proposed MDSH adjustment would generally fail to achieve this fundamental objective due to several material design flaws, the most incongruous of which are discussed below.

De Minimis Threshold

The proposed MDSH adjustment contains a de minimis threshold that would prevent its application with respect to jurisdictions in which a MNE group has taxable

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[2] OECD, *The Multilateral Convention to Implement Amount A of Pillar One – Overview* 3 (2023), https://www.oecd.org/tax/beps/multilateral-convention-amount-A-pillar-one-overview.pdf.

[3] OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint* para. 501, at 124 (2020), https://read.oecd.org/10.1787/beba0634-en?format=pdf.

profit of less than €50 million, which would significantly limit the number of instances in which the MDSH adjustment would apply. For example, an ordinary distributor earning a 3% return on sales would need to earn $1.7 billion in local sales revenue for the MDSH adjustment to apply. At the same time, however, the draft Pillar One MLC would set a disproportionately low €1 million nexus threshold for Amount A to apply, which would drop to only €250,000 for jurisdictions with a gross domestic product of less than €40 billion.

An obvious consequence of retaining these two wildly disparate thresholds would be a world where many market jurisdictions are entitled to receive reallocations of profit under Amount A to which the MDSH adjustment would not apply. As a result, in-scope MNE groups could suffer double taxation of the same residual profits in many market jurisdictions, which would contravene the policy intention of Pillar One. Treasury should therefore seek to align the MDSH de minimis and Amount A nexus thresholds in any final Pillar One MLC. Alternatively, Treasury should seek to substantially lower the former to reduce its disproportionality relative to the latter.

Jurisdictional Offset Percentage

The proposed MDSH adjustment would also include a jurisdictional offset percentage that varies—between 90% and 25%—based on a market jurisdiction's level of depreciation and payroll or whether such jurisdiction is defined as a Lower Income Jurisdiction. Here again, this proposed design feature would frustrate the policy objectives of Pillar One by adding undue complexity and subjecting in-scope MNE groups to varying degrees of double taxation of the same residual profits in market jurisdictions. Because any jurisdictional offset percentage would have the effect of reducing the potential amount of the MDSH adjustment for a market jurisdiction, Treasury should seek to remove this offset from the final Pillar One MLC.

Treatment of Withholding Taxes

The risk of double counting the same residual profit of an MNE group in a market jurisdiction is particularly acute with respect to withholding taxes (i.e., that a market jurisdiction would tax twice the same item of profit if the jurisdiction were allocated Amount A on top of existing withholding tax liabilities). In view of this risk, the draft Pillar One MLC would take into consideration withholding taxes that are similar to other corporate taxes on business profits. Specifically, the proposed MDSH adjustment would take into account only withholding taxes levied by market jurisdictions on cross-border deductible payments made to other in-scope MNEs; withholding taxes on dividends, capital gains, and payments made to out-of-scope MNEs would not count. At the same time, however, the proposed mechanism for taking relevant withholding taxes into account (the "Withholding Tax Upward

Adjustment") would be subject to three separate limitations: a reduction factor varying between 15% and 70%; an exclusion for normal or routine profit; and the aforementioned jurisdictional offset percentage. In all instances, therefore, there would only ever be a partial offset against Amount A for any withholding taxes levied by the market jurisdiction, ensuring at least some degree of double taxation of the same residual profit.

While the proposed MDSH adjustment reflects an important acknowledgment by the OECD of the specter of double taxation, it regrettably stops well short of what Pillar One's policy objectives require. Instead, Treasury should seek to ensure that any withholding tax paid by an in-scope MNE on payments deductible in a market jurisdiction would decrease the Amount A profit reallocation to that taxing jurisdiction by the amount necessary to avoid double taxation of the MNE's residual profit.

In summary, the proposed MDSH adjustment would not operate to "cap" the profit reallocated to market jurisdictions under Amount A as originally intended. Instead, it would merely "haircut" the gross Amount A calculation through the application of a complex series of formulae and apply only to profitable jurisdictions in large, developed economies. Structurally excluding such a large number of market jurisdictions from the MDSH adjustment would fundamentally undermine the stated policy intention of Pillar One to enhance stability and certainty in the international tax system by coordinating the reallocation of taxing rights while preventing double taxation. Accordingly, Treasury should seek to perfect the MDSH adjustment in the final Pillar One MLC to ensure a dollar-for-dollar offset against any profit reallocated to a market jurisdiction under Amount A.

Removal and Standstill of DSTs and Relevant Similar Measures

As set forth above, Amount A of Pillar One is intended to reallocate the international taxing rights over a portion of the profits of the world's largest and most profitable MNEs to market jurisdictions while requiring the removal and standstill of DSTs and other relevant similar measures. Consistent therewith, the draft Pillar One MLC would provide for the removal of DSTs and relevant similar measures, and it would outline criteria to prevent the introduction of such measures in the future. Critically, these provisions would apply with respect to all companies, not merely to those considered in scope for Amount A purposes, and any breach thereof would lead to the denial of Amount A. But the proposed definition of a DST or relevant similar measure and the proposed procedures for classifying and policing new such measures raise several material concerns.

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Definition of DST and Relevant Similar Measure

Article 39(2) of the draft Pillar One MLC would generally define a DST or relevant similar measure as a tax imposed by a jurisdiction, however described, that meets three cumulative conditions and is not described in a list of exceptions. The three cumulative criteria would require the tax to be (1) applied by reference to market-based criteria (e.g., location of customers and users); (2) ring-fenced to nonresidents or foreign-owned businesses; and (3) outside the scope of tax treaties.

The Chamber is deeply concerned that these cumulative conditions are too restrictive and would not provide the Conference of the Parties sufficient discretion to properly evaluate new unilateral measures, resulting in a proliferation of discriminatory taxes that should be treated as DSTs or relevant similar measures. Treasury, therefore, should seek to make these conditions *disjunctive* in any final Pillar One MLC. Alternatively, at the very least, Treasury should strive to liberalize the second criterion requiring a tax to be "ring-fenced" to nonresidents or foreign-owned businesses on a de jure or de facto basis. This could be accomplished by, for example, revising Article 39(2)(b)(ii) to require only that the tax applies revenue thresholds, exemptions for taxpayers subject to domestic corporate income tax in that jurisdiction, or other scope restrictions that cause the measure to apply in practice *principally* to nonresident or foreign-owned businesses.

Elimination of Amount A Allocations for Parties Imposing DSTs and Relevant Similar Measures

Another concerning aspect of the draft Pillar One MLC is how it may be interpreted by less scrupulous jurisdictions contemplating the adoption (or retention) of a unilateral DST or relevant similar measure instead of capitalizing on Amount A. As currently drafted, nothing in the Pillar One MLC would appear to restrict a market jurisdiction from making this choice, meaning jurisdictions with the most aggressive unilateral measures would have the least incentives to implement Amount A. Tacitly allowing market jurisdictions the prerogative to impose or retain DSTs or relevant similar measures would contravene Pillar One's underlying policy objectives to enhance stability and certainty in the international tax system through coordinating the reallocation of taxing rights. We therefore urge Treasury to seek more impactful consequences for jurisdictions that opt to impose DSTs or relevant similar measures instead of Amount A (e.g., preclude such jurisdictions from participating in the Conference of the Parties, suspend information sharing with such jurisdictions).

Removal of a DST or Relevant Similar Measure

Where a jurisdiction's existing unilateral measure is found to be a DST or relevant similar measure by the Conference of the Parties, the draft Pillar One MLC provides that Amount A will be denied only for the period starting on or after the date of the Conference's decision—not retroactively. Allowing a DST or relevant similar measure to remain in effect pending its adjudication by the Conference of the Parties would perversely incentivize market jurisdictions to enact such measures in the first place since any negative consequences would be substantially deferred. Ideally, the final Pillar One MLC should require repayment of any amounts collected under such a DST or relevant similar measure. At a minimum, however, amounts collected under such a DST or relevant similar measure should remain creditable against any Amount A owed to that jurisdiction until there is an offset.

Elimination of Double Taxation – Relief for Amount A Taxation

As previously mentioned, the Pillar One MLC is designed to enhance stability and certainty in the international tax system by coordinating the reallocation of taxing rights under Amount A with a corresponding obligation to relieve double taxation. As currently drafted, however, Part IV of the Pillar One MLC would conspicuously fail to ensure the elimination of double taxation in certain circumstances. For instance, Article 12 of the draft Pillar One MLC describes four different methods that a relieving jurisdiction could use to provide relief from double taxation under Amount A: (1) by direct payment; (2) refundable tax credit; (3) nonrefundable tax credit; (4) or deduction. This degree of flexibility alone raises obvious concerns about inconsistent treatment among jurisdictions leading to double taxation. And for jurisdictions opting to provide relief via nonrefundable tax credit or deduction, such jurisdictions would be required to allow the carry-forward of any unutilized amounts for only three fiscal years.

The Chamber respectfully submits that Part IV of any final Pillar One MLC must more effectively ensure the elimination of double taxation—an essential element of any plan to enhance stability and certainty in the international tax system. Given that U.S. MNEs are expected to make up roughly half of all those subject to Pillar One, it is incumbent on Treasury to champion the adoption of a simpler, more effective mechanism for the relief of double taxation of amounts reallocated under Amount A.

Enhancing Stability and Certainty in the International Tax System

The Chamber appreciates the years-long effort by the OECD/G20 Inclusive Framework toward a consensus-based solution to address the tax challenges arising from the digitalization of the economy. The public release of the draft Pillar One MLC

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represents an important milestone in this monumental effort and is intended to enhance stability and certainty in the international tax system by coordinating the reallocation of taxing rights with a corresponding obligation to relieve double taxation. And yet, even if Treasury were ultimately successful in meaningfully addressing all the major concerns raised herein, recent developments at the United Nations and elsewhere threaten to undermine whatever stability or certainty Pillar One might otherwise achieve.

On November 22, the United Nations voted 125–48 to approve a resolution to establish a framework convention for international tax cooperation, which would shift negotiations from the OECD to the United Nations.[4] As characterized by former Deputy Assistant Secretary for Multilateral Tax, Itai Grinberg, the U.N. vote effectively indicates that 125 countries do not support Pillar One as a medium-term solution to stabilize the international tax system.[5] And this development occurred in the context of other countries' recent moves toward imposing new unilateral, discriminatory DSTs or relevant similar measures (e.g., Canada, Colombia).

Until such time as the OECD's deliberations and economic impact assessments become more transparent, with detailed, jurisdiction-specific estimates of in-scope profits, in-scope MNEs, and the impacts on tax bases and tax revenues made available to member countries and taxpayers alike, it is hard to envisage why any of those 125 countries would choose to adopt Pillar One over an alternative measure. Congress, moreover, has repeatedly sought such transparency from Treasury. For the Pillar One process to remain viable and reach a conclusion in 2024, therefore, the Chamber calls on Treasury to adopt a more transparent approach and engage more proactively with lawmakers and taxpayers during the pivotal months ahead. The Chamber believes that taking such an approach may help to quell some of the increasing interest in alternative tax cooperation fora like the United Nations.

Finally, given the need to address—and potentially renegotiate—the many significant issues raised herein, we respectfully urge Treasury to seek an appropriate extension for the moratorium on imposing newly enacted DSTs or relevant similar measures on any company, which is currently set to expire on December 31. For obvious reasons, securing such an extension will be critical to reaching a workable, durable conclusion to the Pillar One process.

* * *

[4] *See* Sarah Paez, *U.N. Tax Cooperation Resolution Passes in Committee Vote*, 112 Tax Notes Int'l 1444 (Dec. 4, 2023).

[5] *See* Chris Cioffi, *OECD Global Tax Pact Lobbying Ramps Up Among Corporate Giants*, Bloomberg Law (Nov. 7, 2023).

The preceding comments are by no means exhaustive but represent some of the most acute, widespread concerns among a group of in-scope U.S. MNEs from across the industry spectrum. Given the fundamental nature of these concerns, the Chamber would counsel the Biden administration against signing any final Pillar One MLC that fails to materially address them. Instead, we respectfully urge Treasury to engage constructively with the business community—and Congress—to address these and other issues critical to enhancing stability and certainty in the international tax system. To that end, we would welcome the opportunity to discuss our comments with you or your colleagues in further detail and provide whatever additional information you may require. Thank you for your time and attention.

Sincerely,

Watson M. McLeish
Senior Vice President, Tax Policy
U.S. Chamber of Commerce

cc: The Honorable Ronald L. Wyden, Chairman, Committee on Finance, United States Senate
The Honorable Michael D. Crapo, Ranking Member, Committee on Finance, United States Senate
The Honorable Benjamin L. Cardin, Chairman, Committee on Foreign Relations, United States Senate
The Honorable James E. Risch, Ranking Member, Committee on Foreign Relations, United States Senate
The Honorable Jason T. Smith, Chairman, Committee on Ways and Means, United States House of Representatives
The Honorable Richard E. Neal, Ranking Member, Committee on Ways and Means, United States House of Representatives
Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation, United States Congress

American Chemistry Council

SUBMITTED VIA EMAIL: WMsubmission@mail.house.gov

March 21, 2024

House Committee on Ways and Means
1100 Longworth House Office Building
Washington, DC 20515

Re: American Chemistry Council Submission for the Record – House Ways and Means Tax Subcommittee Hearing on OECD Pillar 1: Ensuring the Biden Administration Puts Americans First

Dear Chairman Kelly and Ranking Member Thompson:

The American Chemistry Council (ACC) submits these written comments as part of the record for the House Ways and Means Tax Subcommittee Hearing on OECD Pillar 1: Ensuring the Biden Administration Puts Americans First, held on March 7, 2024. We thank the Tax Subcommittee for holding a hearing on this important issue.

ACC, based in Washington, D.C., represents the leading companies engaged in the business of chemistry. ACC member companies apply the science of chemistry to create and manufacture innovative products that make people's lives better, healthier, and safer. A complete listing of our member companies can be found at our website www.americanchemistry.com.

ACC agrees with the consensus recommendation of the subcommittee: the United States should stay at the table for the Pillar One negotiations. Moreover, Congress should play a significant role in further crafting Pillar One, as it will be up to both houses of Congress to legislate domestic law to allow the United States to determine and collect its share of revenue under Pillar One. In addition, Pillar One will be implemented in part through a multilateral convention (MLC), which will require congressional involvement, specifically advise and consent by the Senate.

We believe a Pillar One that reflects and advances the interests of Congress, the Administration, and business could create a more stable international tax system. Such stability should result in tax certainty for both governments and business. A stable system should reduce multilateral and bilateral tax disputes, as discussed at length in the hearing.

The remainder of ACC's comments address the Pillar One process and technical issues that should be addressed in the next draft of the MLC. The OECD released components of Pillar One with some input from the business community, but the OECD did not offer additional consultations of the complete package. ACC views this as a defect in a process designed to fundamentally reform how countries tax multinational enterprises (MNEs).

The Pillar One MLC represents a fundamental change in taxing rights established by the League of Nations in the 1920s. Specifically, current treaties rely on some form of physical presence in a jurisdiction as a precondition to tax business profits. The United States Model Income Tax Convention (2016) defines a permanent establishment as including some form of physical presence, such as an office or a factory, but also provides a specific carveout for a warehouse of goods.

The Pillar One MLC departs from the concept of a permanent establishment as the minimum connection between a location and moves to a sales-based standard for nexus. The Pillar One MLC establishes nexus over MNEs with € 20 billion with profitability of 10% or greater, based on modified financial statement revenue. Twenty five percent of the excess profits are then redistributed to market jurisdictions, which is referred to as Amount A. An MNE does not need to take any intentional steps for its products to be sold in a market. For example, a component manufacturer can sell to a third-party manufacturer that incorporates its inputs into a finished good that is sold in several markets. The component manufacturer could be subject to tax based on where its customer's finished goods are sold even without any intent to sell in those markets.

ACC has five observations and comments regarding the Pillar One MLC. The first is on process. Business should have another opportunity to consult with the OECD and Inclusive Framework regarding the proposed changes after the release of the Pillar One MLC. There have been numerous technical changes that will require our members to understand whether and how the proposed rules will apply. We applaud Treasury's willingness to consult with stakeholders, and the OECD and Inclusive Framework should replicate that process.

The second set of comments addresses the need for delayed implementation due to the complexity of the Pillar One MLC.

The potential complexity for ACC members is significant because of the requirement to resource the sale of component chemicals to the location of the sale of the finished good. Under Articles 6 and 7, the revenues of a manufacturer of components that are designed to be incorporated directly or indirectly into a finished good that will be sold are treated as "arising in the Jurisdiction in which the finished goods containing the component are delivered to the final customer."[1] However, a chemical that is used in a process but does not become part of a finished good is not a component for purposes of Amount A. This will require ACC members to ascertain the use of the chemicals by their customers to separate use as a component.

The ACC notes that it is likely impossible for its members to comply with the MLC's sourcing rules if the Pillar One MLC applies to chemical manufacturers. Most customers of ACC members are below the Pillar One scope and will not collect data required to accurately resource income.

[1] Pillar One MLC, Art. 7(1)(c).

Nor do the customers have the incentive to create systems to support in-scope chemical manufacturers. Unlike the sale of digital goods and services, ACC members are unable to track place of use to an IP address or place of use.

The following example shows the complexity of the issue for chemical manufacturers. In the first example, Chemical Group 1 manufactures emulsions for a wide variety of applications. The emulsions are commonly used in the construction industry as part of backings on a variety of products, including carpeting, papers, as well as paint and caulking. Chemical Group 1 sells the chemicals to various construction industry manufacturers, who incorporate the emulsions into their products. The finished construction products are then sold across the globe to retailers, who ultimately sell the finished construction products to customers. Chemical Group 1 would need to either track the emulsions to ultimate sale of finished products or alternatively demonstrate other reliable factors to establish where revenue should be sourced. Alternatively, assume that while some of Chemical Group 1's customers are manufacturers some customers will use the emulsion as part of their manufacturing process and the emulsion will not be part of a finished good. Chemical Group 1 will need to obtain the data from customers to ensure the appropriate amount of chemical sales are treated as components, versus end sales to manufacturers.

The complexity for ACC members could be reduced in one of several ways. First, as foundational building blocks for every facet of industrial economic activity the exception for extractives could be expanded to include chemical manufacturers. Alternatively, Pillar One could be narrowed to eliminate business-to-business transactions. ACC members sell significant volumes of chemicals to other businesses and cannot track each sale through to the ultimate place of sale of finished goods.

Some ACC members note the new Autonomous Domestic Business Exemption provision foreseen in the MLC. This provision allows an MNE to switch off Amount A's mechanism (both for profit allocation and relieving purposes) for each country where an MNE does not exceed certain thresholds in terms of percentage of intercompany cross-border transactions and imports or exports of products compared to external sales generated by the entities established in the country. If a critical mass of countries or revenues meet the thresholds, the whole multinational group may be out of the scope of Amount A.

This provision is very welcomed for multinational groups having a highly decentralized and local business model, for which the application of Amount A would lead to unintended consequences without any economic rationale.

However, ACC members would like to point out that the thresholds which are set as a cap for the Autonomous Domestic Business to be characterized are extremely low. In particular, the maximum deviation between revenues which are sourced to a jurisdiction per Amount A sourcing rules and the external revenues recognized by the group entities in that jurisdiction is plus or minus 5%: this is very low even for highly localized businesses. The ACC members respectively suggest that the Inclusive Framework raise this threshold to 10%, which would be more realistic. Otherwise, the groups which benefit from these tests may face a "cliff effect" as soon as they cease to meet the thresholds, immediately entering into the extreme complexity of Amount A's mechanism.

To the extent ACC members remain in scope of Pillar One, members will need significant time to hire additional staff and resources to compile the data required to capture ultimate place of sale, data that is currently not available. Members may also need to modify contracts to obtain the data from third parties regarding ultimate place of sale of finished goods or other data sufficient to generate reliable allocation keys. These changes are on top of significant burdens placed on the business community through the rapid implementation of Pillar Two. We recommend a multi-year delay to provide MNEs and tax authorities the opportunity to onboard the Pillar One MLC. This will also allow tax authorities to hire and prepare for dispute resolution.

Our third observation is regarding potential design flaws in the Pillar One MLC. ACC members have significant expenses related to the research and development of chemicals and processes. While market jurisdictions will claim a greater share of the profits, they do not want to share in the costs of development and management of such products. This creates an economic mismatch. The mismatch is pronounced where an MNE lacks any presence in the market other than the ultimate destination of its goods.

Similarly, it is unclear why there is any discount on withholding taxes collected by market jurisdictions. Withholding taxes should receive full credit against Amount A profits reallocated to a market jurisdiction.

The fourth observation revolves around dispute resolution. The Pillar One MLC moves in a positive direction for purposes of resolving both Amount A disputes and Related Issues. ACC supports mandatory binding arbitration to resolve cross-border disputes between countries. We believe it will play an important role if and when the Pillar One MLC enters into force.

To reduce the instance of double taxation, the ACC recommends including mandatory binding arbitration beyond Amount A to include Related Issues. ACC members will be unable to obtain certainty if some countries can opt out of binding arbitration on transfer pricing, permanent establishment, and other issues that will affect the distribution of Amount A. We are concerned that some Inclusive Framework members routinely prevent taxpayers from seeking relief from double taxation under an applicable treaty, which will prevent MNEs from receiving certainty under Amount A.

Finally, ACC believes in a robust Amount B[2] that will provide certainty for routine services and sales. The Amount B draft published by OECD on February 19, 2024, is incomplete and requires significant work. The new draft is too narrow in scope by only covering the sale of goods. It should be expanded to include routine services. Further, the draft allows countries to elect when they will use Amount B, which means Amount B will become the new floor for the pricing of routine services. This is unacceptable and will lead to additional tax controversies. We look forward to a continued engagement with the OECD and Inclusive Framework on Amount B and believe an expanded draft is warranted. Finally, Amount A should not move forward without an enhanced Amount B that is mandatory and applies to both goods and services.

[2] Amount B would create a transfer pricing methodology safe harbor for in-scope marketing and distribution activities.

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ACC appreciates the opportunity to submit comments to the House Ways and Means Tax Subcommittee. Please feel free to contact me if you would like to discuss ACC's comments. Thank you.

Very truly yours,

Robert B. Flagg
Senior Director, Federal Affairs
American Chemistry Council

THE NATIONAL FOREIGN TRADE COUNCIL

SUBMISSION OF WRITTEN COMMENTS FOR THE HEARING RECORD

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TAXATION

HEARING ON OECD PILLAR ONE: ENSURING THE BIDEN ADMINISTRATION PUTS AMERICANS FIRST

March 21, 2024

Mr. Chairman, Ranking Member, and Members of the Subcommittee:

The National Foreign Trade Council (the "NFTC") is providing written comments as part of the record for the *Tax Subcommittee Hearing on OECD Pillar 1: Ensuring the Biden Administration Puts Americans First*, held on March 7, 2024. We thank Chairman Jason Smith, Ranking Member Neal, Subcommittee Chairman Mike Kelly and Subcommittee Ranking Member Mike Thompson for holding a hearing on this important issue.

The NFTC, organized in 1914, is an association of 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 ("IF") in establishing and maintaining international tax and transfer pricing norms that provide certainty to enterprises conducting cross-border operations. We further value the work and efforts of the Congress and the U.S. Department of the Treasury ("Treasury") in defending and advancing the interests of U.S. businesses.

General Comments

NFTC and our members are interested in a successful outcome of the Pillar One negotiations. A successful outcome would stabilize the international tax system by eliminating digital services taxes and other unilateral measures (together, "DSTs") that disproportionately target U.S. technology companies, providing for a principled reallocation of taxing rights and minimizing complexity, uncertainty, and the potential for double or excessive taxation. The Pillar One negotiations are important to addressing the lack of stability within the current system and the threat of numerous unilateral and discriminatory DSTs targeting U.S. companies. It is vital that we prevent the spread of additional discriminatory tax measures that specifically target American companies and industries. We urge the United States to stay at the table and negotiate the best resolution possible for U.S. businesses and the U.S. economy.

The draft Multilateral Convention ("MLC") to implement Pillar One, published in October 2023, is a significant step forward in the Pillar One negotiations. NFTC welcomed the consultation on the MLC held by Treasury last year. During that consultation, we outlined our concerns while reinforcing the call for continued negotiations resulting in a global commitment to a successful outcome.

The appeal of the Pillar One proposal for U.S. businesses lies in both its components, Amount A and Amount B. Amount A would permit a reallocation of taxing rights (i.e., a shift of income, referred to as Amount A, to "market jurisdictions" to be subject to net tax by such jurisdictions) in exchange for the elimination of DSTs. Amount B aims to create a simplified approach for benchmarking routine returns for distribution activities, thereby reducing or eliminating disputes in this contentious area.

At this point, even with the significant progress made, numerous technical and policy issues remain. Many of these issues are outlined below. Due to the number of outstanding issues, NFTC is still considering whether we can support the MLC. We urge Treasury and the other IF members to continue their work and resolve the outstanding issues in a manner that is principled, avoids undue complexity, and avoids double taxation, and is to the benefit of all U.S. based multinational enterprises ("MNEs").

The critical role the Congress plays in Pillar One cannot be understated. Pillar One cannot move forward without the implementation of Pillar One in U.S. law. (In this respect, Pillar One is very different from the domestic minimum taxes being adopted by many countries as a result of Pillar Two). Implementing Pillar One into U.S. law would require the United States to adopt the MLC through legislation and as a treaty, and to adopt significant changes to the Internal Revenue Code. Such changes would be unprecedented and therefore, would be difficult even with broad consensus as to the advisability of Pillar One. The stakes are high. The failure of Pillar One work could result in the proliferation of DSTs targeted at U.S. companies with unpredictable consequences. But an unprincipled or deficient Pillar One deal would also have negative consequences, including tax uncertainty, complexity, double taxation, and replacing one unstable system with several overlapping systems. We respectfully suggest that the Committee continue to engage with U.S. businesses, Treasury, and other stakeholders as this process moves forward to maximize the potential for a successful outcome.

Specific Comments

Elimination of DSTs and Similar Measures

A critical objective of Pillar One is the elimination of DSTs and similar measures (such as significant economic presence ("SEP") nexus rules). These taxes are discriminatory because they intentionally target U.S. technology businesses. And they are unfair because they are imposed on gross revenues without regard to whether there was a profit or a loss.

The MLC does not yet meet the objective of eliminating DSTs and similar measures. To highlight one example, the current definition prohibits taxes that are "discriminatory" based on narrow and loose standards that would permit countries to continue to apply DSTs. We urge policymakers to ensure that Pillar One actually accomplishes the goal of eliminating DSTs by providing a broad and unambiguous definition of prohibited taxes that look to the predominant effect of the tax rather than stated intent or other subjective or ambiguous criteria.

Technical Operation of Amount A - Sourcing Rules

The sourcing rules of Pillar One are foundational because they are used to determine the countries to which income may be reallocated to (or from) under Pillar One. In many cases, these rules are complex, unworkable, and arbitrary. While the current MLC incorporates some comments from businesses and therefore represents a step forward from earlier drafts, further changes are necessary.

To highlight one example, the sourcing rules for services provided to "large" commercial customers generally rely on a headcount allocation. These rules are not practical and overly burdensome. Taxpayers would need to segregate their customers into subsets and then obtain customer-specific (and non-public) information as to those customers' headquarters locations.

A separate example is component manufacturers, who often sell their products in bulk to a limited customer base. The ultimate end use or destination of their components is largely unknown to the manufacturer. These manufacturers, who are in the scope of Amount A, must deal with tax uncertainty and unnecessary compliance complexity. Thus, they must use allocation keys and make estimates based largely upon the Gross Domestic Product ("GDP"). Determinations based on the OECD allocation key will result in the largest allocations going to the U.S., China, and Germany.

To highlight another example, the sourcing rules for services provide that customers should be segregated into three categories (small, large, and resellers). In theory, separating customers into three buckets and applying a tailored allocation method seems logical. In practice, applying different allocation methods may require information not routinely contained in systems or obtained from customers as a matter of course. At times, customers are also resellers, which would require segregating the revenues between those that relate to the seller as a customer versus those that relate to resale transactions in order to apply the different sourcing criteria. This is seemingly impractical and, in some cases, impossible.

Technical Operation of Amount A -- Marketing Distribution Safe Harbor ("MDSH")

The MDSH is important to the operation of Pillar One because it ensures that market jurisdictions do not receive a double allocation of profits. The MDSH in the current MLC needs refinement before finalization. We are concerned that many of the design elements are not based on economic principles and are seemingly arbitrary. We have requested that the OECD provide a rationale as to the design elements chosen. Without ties to an economic principle, these elements are arbitrary, thereby making them susceptible to future adjustments based on political or other considerations. It would be difficult to obtain the goal of stability if these values are subject to future adjustment.

We are concerned because the MDSH does not fully eliminate double allocations of profit, thereby creating an incentive for market jurisdictions to audit taxpayers and increase taxable income outside of Amount A. This may allow jurisdictions to collect additional revenue (irrespective of the arm's length principle) without impacting their guaranteed Amount A allocation. In order to safeguard against this, and as discussed below, we have recommended mandatory implementation of Amount B as an optional safe harbor on which taxpayers can rely. In its current form Amount B has a limited scope which may not mitigate disputes as envisioned. Tax authorities will simply focus the activities and functions outside the scope of Amount B.

We are also concerned that the MDSH reaches inappropriate results in the case of franchise or split-ownership business models. The MDSH in the current MLC only accounts for residual profits earned by entities whose results are consolidated with the taxpayer. The profits earned by unconsolidated franchisees or distributors in the market jurisdiction are not taken into account, even in cases in which such entities earn a share of the residual profits from the overall supply chain. This would result in a double allocation of residual profits to market jurisdictions and would create significant economic distortions as the profits from the overall supply chain would be taxed differently depending on whether a taxpayer operated through consolidated or unconsolidated franchisees or distributors. We urge policymakers to address this issue and ensure that the MDSH is neutral across business models.

Technical Operation of Amount A -- Adjustment for Withholding Taxes

The current MLC introduced a mechanism to account for withholding taxes imposed by a market jurisdiction, which reduces the Amount A allocation to that market jurisdiction. Like the MDSH, an adjustment mechanism to account for withholding taxes is critically important to ensure that market jurisdictions are not permitted double allocations of income. We are concerned that the adjustment mechanism in the current MLC will not be effective and will lead to double taxation. The adjustment mechanism falls short of requiring a dollar-for-dollar adjustment for withholding taxes. While we understand that this measure was the result of a political compromise with jurisdictions that rely on withholding taxes, we note that several such jurisdictions have reserved this point. More fundamentally, anything short of a dollar-for-dollar adjustment for withholding taxes will have the perverse effect of endorsing existing withholding taxes on income, such as royalties or service fees, or even encouraging the introduction or increase of such taxes in contravention of long-standing U.S. policy. We urge policymakers to push for a dollar-for-dollar adjustment for withholding taxes.

Technical Operation of Amount A -- Double Taxation and Coordination with Pillar Two

Pillar One introduces new risks of double taxation, in particular, the risk that the income allocated to market jurisdictions will nevertheless continue to be taxed in the jurisdiction in which it was actually earned and reported. The current MLC provides limited assurances that the obligation to relieve double taxation will be fully satisfied. We are also concerned that the alternative mechanisms proposed to relieve double taxation may not work as seamlessly as envisioned, given the potential issues involving integration with existing domestic tax regimes. We request policymakers to provide further guidance in the MLC to ensure full relief from double taxation on any Pillar One tax liability.

We understand that the integration of Pillar One and Pillar Two will be part of the Pillar Two discussions. Several clarifications are needed, including an ordering rule and confirmation that Pillar One tax should be treated as a Covered Tax in the relieving jurisdiction rather than the jurisdiction of the Designated Payment Entity. Clarifications as to whether Global Anti-Base Erosion Model Rules ("GloBE") income adjustments are necessary to incorporate the surrender effects of Pillar One calculations is also needed. In addition, Amount A is optional for countries to implement, which includes both relieving jurisdictions and recipient jurisdictions. This optionality creates the potential for double taxation. This could occur when a recipient jurisdiction determines that a digital services tax or other similar tax raises more revenue and thus there's no incentive to comply or when a relieving jurisdiction opts out from providing relief from double taxation on profits reallocated to market jurisdictions. These issues must be addressed in order to ensure the integrity of the system and ensure the goal of Amount A eliminating discriminatory taxes. Supporting the implementation of Amount A and Amount B without knowing the link between these two concepts and without knowing what the relation is with Pillar Two is concerning.

Amount A -- Tax Certainty & Mutual Agreement Procedure ("MAP")

Tax certainty is a central tenet of Pillar One. The current MLC introduced novel concepts, such as reallocating the tax base of America's biggest corporations to foreign governments, to attempt to provide such certainty. In general, these provisions favor jurisdictions with broad tax treaty networks. NFTC continues to advocate for countries, particularly the United States, to build upon their existing networks of bilateral tax treaties. We note again that the United States has a relatively narrow network of tax agreements compared to other countries; for example, the United States does not have tax agreements covering Singapore, Hong Kong, most of Latin America, and most of Africa. This relatively narrow network puts the United States at a competitive disadvantage and may reduce the benefits of the dispute resolution mechanisms being developed by the IF. We urge U.S. policymakers to recommit themselves to the U.S. tax treaty program, bring additional transactions and arrangements under these dispute resolution mechanisms, and further pledge the NFTC's continued support for these efforts.

The dispute resolution procedures outlined in the current MLC can be improved. For example, we have requested that a binding timeline be created to ensure timely dispute resolution. Tax disputes in foreign jurisdictions can take years or even decades to resolve. Any extension of this timeline should require the consent of the affected taxpayer. Without such a timeline, uncertainty will become widespread due to the layers of impacts contained in Pillar One and potentially Pillar Two.

The MLC also includes some verbiage suggesting that jurisdictions may disregard the rules. In the spirit of encouraging dispute resolution and stability, these references should be removed. To the extent there are policy issues underlying such language, those issues should be addressed in a more tailored manner so as not to frustrate the resolution of disputes and the avoidance of double taxation.

Amount A -- Taxpayer Data

The MLC requires detailed calculations involving sensitive taxpayer data. We urge policymakers to develop additional guardrails to mitigate the distribution of sensitive taxpayer data and to limit the use of that data to the greatest extent necessary. Deterrence and protective measures must be put in place for any breaches of confidentiality since taxpayers cannot rely on each country's domestic protections.

Amount B

Amount B could be a critical part of the Pillar One work if it provides a simplified and streamlined approach to determine the returns to distribution and marketing activities, thereby limiting tax disputes in this contentious area. At present, Amount B does not meet its objectives because it is too limited in scope and because jurisdictions can choose not to apply it (or even respect the application of Amount B by other jurisdictions). To be effective, Amount B should be mandatory for all jurisdictions and provided as an optional safe harbor for all taxpayers in the scope of Amount A. The scope of Amount B, currently limited to the distribution of goods, should be broadened to all distribution and similar activities, including distribution in relation to services and digital property and retail with no "ring fencing" of distribution activities or exclusions. No qualitative criteria should be accepted, and vague concepts that would decrease the certainty of Amount B should be removed.

As currently designed, Amount B is optional for tax authorities to apply. This is counter to the underlying purpose of creating certainty. For example, New Zealand has announced that not only will they not apply Amount B, and they will also not allow for correlative adjustments when profits taxed in New Zealand are taxed somewhere else as a result of Amount B. Uneven adoption of Amount B could create additional instability in the system rather than creating the stability and dispute prevention it was intended to create.

It is important to ensure that taxpayers can rely on Amount B and that the scope of Amount B is expanded. The failure to include digital goods and services ignores the modernization of the global economy, which was part of the impetus of this project. The OECD has failed to show that distribution activities of digital goods and services vary significantly from that of tangible goods. Transfer pricing disputes on these items are rampant and will only continue to increase over time. Providing a reasonable deemed return on routine distribution activities makes sense for both taxpayers and tax administrators. This allows the dedication of limited resources to truly complex or novel issues. Further work must be done on the pricing matrix particularly with respect to sovereign risk adjustments, which require allocations beyond an arm's length return in certain jurisdictions. We urge Congress to work with Treasury in pushing the OECD to improve the current guidance related to Amount B.

Conclusion

We recognize the significant progress that has been made to date on Pillar One. That said, several important outstanding issues remain with the current MLC and with Amount B, as detailed above and in our December 12, 2023, comment letter to Treasury. We appreciate the Subcommittee's interest in this critical issue and its engagement with the business community on these matters. Due to the number of outstanding issues, we suggest Congress continue engagement as this process unfolds.

As we are still considering whether we can support the MLC, we urge the parties to continue their work to resolve the outstanding issues in a manner that is principled, avoids undue complexity, and avoids double counting or double taxation of the same income. We believe that any negotiated outcome that falls short of these objectives will ultimately fail to bring stability to the international tax system.

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Thank you for the opportunity to submit these written comments for the record. The NFTC looks forward to working with you, your staffs, and all Members of the Committee to ensure that Pillar One does not adversely impact the competitiveness of the U.S. economy and of worldwide American companies.

We are happy to answer any questions or provide clarification on any of the issues raised. Please contact Anne Gordon, Vice President for International Tax Policy at agordon@nftc.org.