December 12, 2020

OECD Centre for Tax Policy and Administration
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Re: OECD Inclusive Framework – Public Consultation on the Report on the Pillar One Blueprint

BSA | The Software Alliance[1] provides the following information in response to your request[2] for written submissions in relation to the Reports on the Pillar One and Pillar Two Blueprints. BSA commends the OECD Secretariat for its ongoing efforts to develop a unified taxation approach for consideration by 137 jurisdictions under the Inclusive Framework.

BSA offers in this submission brief comments on the proposed inclusion of cloud services and business software within the scope of automated digital services (ADS) in the Pillar One Blueprint.[3] BSA's comments apply broadly to the OECD's questions regarding "the design and implementation of the proposed activity test" (Question 1), the "design of a specific Amount A revenue threshold" (Question 2), and rules to establish nexus and avoid double counting (Questions 3, 7, 8). BSA outlines several concerns and recommendations below.

I. Overview of Pillar One Blueprint Provisions on Cloud Services and Business Software

The Pillar One Blueprint would include within the scope of ADS "cloud computing services," which is defined as "the provision of network access to on-demand standardised information technology (IT) resources, including infrastructure as a service, platforms as a service, or software as a service (such as computing services, storage services, database services, migration services, networking and content delivery services, webhosting, and end-user applications and software)."[4] The Pillar One Blueprint further specifies that the scope of this term covers the following:

- Computing services include virtual servers in the cloud, the ability to run and manage web apps using remote computing, the ability to run code on remote computers in response to events and the ability to run batch code jobs at scale;
- Storage services include storage in the cloud and data transport;

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- Database services include data warehousing, database management and caching systems;
- Migration services include database migration and data transport;
- Networking and content delivery services include access to a virtual private cloud (an isolated cloud that the customer can control) and use of a global content delivery network (whereby content such as videos are transferred to viewers at high transfer speeds);
- Web hosting services include website and webpage hosting; and
- End-user applications and software services include systems permitting users to develop access or use software and applications.[5]

The Blueprint states that any standardized cloud computing services, including those that may be configured together for a particular customer, would be covered. (On the other hand, the Blueprint proposes an exclusion for "bespoke" cloud computing services that are customized to service the needs of a particular client, as such services are "closer to engineering and consulting services, i.e. professional services."[6] Where a cloud computing service provider provides a bundled service comprising standardized and customized services, specific rules for "dual category ADS and bundled services" would apply.[7]

Aside from cloud services, the Blueprint also proposes to include downloadable software as a type of "digital content service," in cases where "the provision of that software is automated requiring minimal human involvement to make it available to users and the software is delivered over the Internet." Two exceptions would be for software acquired as a tangible product (e.g., delivered via CD) or for "highly customized" software.[8] Thus, under this definition even software sold in a business-to-business transaction (e.g., a typical license of software) would be included in scope if the software is delivered electronically to a customer, unless the software satisfies the uncertain and subjective "highly customized" description.

II. Discussion

BSA supports the OECD's efforts to develop a unified taxation approach for consideration by 137 jurisdictions through the Inclusive Framework. However, BSA is concerned that the proposals to include cloud computing services and traditional licensed business software products within Amount A, and the design of those proposals, creates a risk of inconsistency with binding international trade rules under the WTO Agreement. BSA is also concerned that the inclusion of cloud computing services and licensed business software within Amount A undermines the integrity and coherence of the Inclusive Framework, and will result in unintended economic consequences, further complicating a landscape characterized by a large number of unilateral and distortive digital tax measures.

A. Avoidance of Discrimination and Inconsistency with International Trade Rules

The WTO Agreement prohibits taxation measures that afford less favorable treatment to imported digital products, services or enterprises vis-à-vis their domestic analogues in respect of the sale or use of such products or services, or in respect of other activities of such enterprises.[9] Inclusive Framework negotiators should be careful to avoid promoting rules that would impose significant tax liability on foreign cloud service and business software suppliers, while effectively exempting local counterparts that offer competing services. Such rules could result in "internal taxes or charges on imported products (imposed directly or indirectly) in excess of those imposed on like domestic products,"[10] "taxes and charges applied so as to afford protection to domestic production,"[11] or treatment less favorable to foreign services or service providers "than that it accords to its own like services or service providers."[12] An Inclusive Framework outcome would raise serious legal concerns if it promoted the modification of conditions of competition in this way.

Complex definitional scoping, dual category rules, and various types of thresholds (e.g., arbitrary revenue thresholds, profit escalators, phase-ins, etc.) are easily designed to afford protection to domestic enterprises, products or services, while burdening foreign enterprises, products, or services. For example, in the context of cloud computing services and business software, significantly uncertainty and controversy is likely to arise

as a result of the ill-defined distinction between "automated" digital services and software requiring "minimal" human involvement, on the one hand, and "bespoke" or "highly customized" services and software, on the other.

Thus, we recommend that all cloud services and business software be taken out of scope of Amount A by removing references to cloud computing services and business software from the positive list and placing them on the negative list. This clarification is preferable to establishing a framework based on the vague and potentially contentious distinctions outlined above. Similarly, the proposed special dual category rules should be eliminated due to the subjectivity they introduce into the determination of whether a particular activity is in scope.

As outlined above, there are concerns that the current design and application of the Inclusive Framework to cloud computing services and business software – and the proposal to apply special scoping and threshold-based exemptions from this coverage – could promote tax rules in tension with WTO non-discrimination obligations. An Inclusive Framework outcome that appears to be presumptively at odds with WTO norms is to be avoided.

B. Ensuring Policy Coherence and Avoiding Unintended Consequences

As stated in the Pillar One Blueprint report, "cloud computing is unlike other ADS above because it is of most relevance to other businesses."[13] Cloud computing services are enabling technology inputs that exist almost exclusively in an enterprise setting. They are not typically "end services" consumed directly by consumers or other purchasers, but rather they are inputs in a business-to-business setting, constituting enabling service inputs that make businesses more efficient and competitive. The same holds true for business software, which is similarly a business input not unlike intermediate products or components excluded from Amount A.

Because cloud computing services and business software are the digital backbone of manufacturing and services economies, imposing higher taxes on these enabling technologies will hurt local innovation and competitiveness. Raising the costs for local manufacturing and services industries to access best-in-class cloud computing services and business software solutions would undermine growth and innovation, business operations, and the transfer of technology to local industries. Cloud computing services and business software enable the digital tools and insights that are critical to enabling governments and companies of all sizes to remain productive during the COVID-19 crisis, create jobs, boost efficiency, drive quality, and improve output.

Additionally, cloud computing services offer advantages from an environmental and carbon consumption perspective vis-à-vis on premises computing services. Imposing higher levels of taxation on these business inputs will end up harming the productive capacity and efficiency of the businesses and enterprises that rely on them to compete at home and abroad, and may push those companies to import and install carbon-intensive on-premises computing infrastructure – leading to non-optimal environmental externalities.

Cloud computing services and business software are business-to-business productivity tools that are frequently tailored and configured to user specifications. They offer clear economic benefits of enhancing local enterprise competitiveness and reducing carbon emissions, and should be excluded from the scope of amount A.

Recommendations

BSA makes the following recommendations in light of the foregoing comments:

1. The OECD should stipulate that all Inclusive Framework members commit to withdraw all unilateral tax measures upon agreement of the OECD BEPs framework, rather than upon national implementation thereof. Consideration should be given to a list by country of those specific tax measures that are "relevant unilateral measures" and that should be repealed.

2. Individual jurisdictions should not be afforded with discretion to make unilateral changes to the positive and negative lists under Amount A. Affording individual jurisdictions with such discretion would greatly increase uncertainty and the potential for double taxation. The positive and negative lists should be defined as specifically as possible with no possibility of a non-principled deviation from the lists by any Inclusive Framework member.

3. Any final agreement must not ring fence or discriminate against particular automated digital services or countries via arbitrary scoping, phase ins, thresholds, profit escalators, or other methods that can be used to target taxes towards foreign enterprises or their products or services. An Inclusive Framework outcome that modifies conditions of competition in this way, and that is presumptively at odds with WTO non-discrimination rules, is to be avoided.

4. An effective means of avoiding double counting is critical – particularly where businesses are already adequately compensating market jurisdiction. The vast majority of multi-national enterprise (MNE) revenue is earned in jurisdictions where the enterprise has a taxable presence, which would not normally be established in jurisdictions that contribute only relatively small revenue streams. Inclusive Framework members should take special care to avoid promoting administratively burdensome rules: (a) that allocate small returns to jurisdictions where enterprises have no taxable presence; and (b) where the enterprise's routine returns are properly due to the jurisdiction in which the enterprise undertakes its commercial activity, makes capital expenditures, owns assets, and assumes risk.

5. As one approach to addressing the aforementioned concerns, BSA recommends that Amount A should focus on remote sales booked outside a market jurisdiction. Amount A should not apply with respect to the activities of an MNE's local subsidiary or other permanent establishment.[14]

6. As an additional approach to address the concerns noted in Section B above, BSA recommends that a straightforward business-to-business exception be applied in the ADS context for B2B cloud services and licensed business software. This would bring the ADS rules in line with Consumer Facing Business rules, where a similar exception for intermediate inputs exists. Such a simple exception would also aid in administrability and support coherence with other international legal standards, as it could replace the proposed complex dual category rules, revenue thresholds, and other features that can be misused for protectionist ends and that create particular international legal risk under WTO rules.

7. The marketing and distribution safe harbor is a critical component of any agreement. It should be effectuated by comparing the marketing and distribution safe harbor fixed return number (Amount B) to the profit already allocated to the marketing and distribution subsidiary under the arms-length principle. If the arms-length principle allocation exceeds the marketing and distribution safe harbor fixed return (Amount B), then any excess would reduce or eliminate the Amount A allocation.

8. To the extent that withholding taxes relate to the revenue generating nonroutine profits in the local market jurisdiction, withholding taxes should be applied to reduce the amount of tax on the Amount A re-allocation. A withholding tax on outbound royalties (and in-scope dividends) is taxing a return in the market and should be credited against amounts otherwise due on Amount A.

9. Finally, it will be important to have a dispute resolution mechanism that defers to the lead tax jurisdiction; is limited to jurisdictions with a direct and material interest; and protects taxpayer confidentiality.

[1] BSA | The Software Alliance (www.bsa.org) is the leading advocate for the global software industry before governments and in the international marketplace. Its members are among the world's most innovative companies, creating software solutions that spark the economy and improve modern life. With headquarters in Washington, DC, and operations in more than 30 countries, BSA pioneers compliance programs that promote legal software use and advocates for public policies that foster technology innovation and drive growth in the digital economy. BSA's members include: Adobe, Atlassian, Autodesk, Bentley Systems, Box, Cadence, CNC/Mastercam, IBM, Informatica, Intel, MathWorks, Microsoft, Okta, Oracle, PTC, Salesforce, ServiceNow, Siemens Industry Software Inc., Sitecore, Slack, Splunk, Trend Micro, Trimble Solutions Corporation, Twilio, and Workday.

[2] OECD/G20 Inclusive Framework on BEPS, Public Consultation Document on the Reports on the Pillar One and Pillar Two Blueprints (Oct. 12, 2020), at: http://www.oecd.org/tax/beps/public-consultation-document-reports-on-pillar-one-and-pillar-two-blueprints-october-2020.pdf

[3] BSA members have variously offered comments on the Pillar One and Pillar Two blueprints through other organizations or in their own names. Please refer to those submissions for additional details.

[4] Pillar One Blueprint, Box 2.19.

[5] Pillar One Blueprint, Box 2.20.

[6] *Id.*

[7] *Id.*

[8] Pillar One Blueprint, Box 2.14.

[9] *See* GATT Art. III:4, TBT Art. 2.1, TRIMS Art. 2.1; etc.

[10] *See* GATT Art. III:2.

[11] *See* GATT Art. III:1.

[12] *See* GATS Art. XVII.

[13] Pillar One Blueprint, para. 365.

[14] Alternatively, if there is to be any reallocation of non-routine marketing intangible returns to market jurisdictions, the quantum of Amount A should be modest (e.g., no more than 2% of the remote sales into the market jurisdiction based on empirical data). This approach would limit the scope of Amount A in respect of enterprise cloud computing services and business software to ensure that a modest operating margin percentage of remote sales booked outside a market consistent with a non-routine marketing intangible return is subject to tax in a market jurisdiction with a commensurate reduction in tax due to surrender states. This could be accomplished by starting with a businesses operating margin (or profit before tax) less a profitability threshold (e.g., 10%) multiplied by an allocation percentage (e.g., 10%) to determine the amount of revenue that would be allocated to the market jurisdiction and subject to the local corporate income tax rate. For example:

- A business with a 20% operating margin/profit before tax would have an additional 1% of local sales allocated to the market jurisdiction under Amount A (20%-10% x 10% = 1%).
- A business with a 30% operating margin/profit before tax would have an additional 2% of local sales allocated to the market jurisdiction (30%-10% x 10% = 2%).

In any case, there should be a cap of no more than 2% of local sales, as illustrated in the example above.