ITI Promoting Innovation Worldwide

Written Testimony of

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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

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

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[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."

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

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[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