

**William Morris**

Chair, *Business at OECD* Tax Committee  
13/15, Chaussée de la Muette, 75016 Paris  
France

Tax Policy and Statistics Division  
Centre for Tax Policy Administration  
Organisation for Economic Cooperation and Development  
2 rue André-Pascal  
75775, Paris, Cedex 16  
France

Submitted by email: [TFDE@oecd.org](mailto:TFDE@oecd.org)

**November 12, 2019**

**Ref: OECD Secretariat Proposal for a “Unified Approach” under Pillar One**

Dear Secretariat Team,

Thank you for the opportunity to comment on the Secretariat proposal on Pillar 1 of the *Project On The Tax Challenges Of The Digitalization Of The Economy*. This is a project which (together with Pillar 2) will fundamentally reshape the international tax rules, and we are glad that stakeholder engagement has been encouraged. (And, given the scope of this project, we are also encouraged that you have indicated that this engagement will continue.)

In respect to the attachment to this letter, which contains the views of the members of *Business at OECD* (BIAC), a number of preliminary items should be noted:

- First, it remains our firm belief that the best way to restore stability and increase certainty in the international tax system is through a deep and broad consensus reached among the over 130 members of the Inclusive Framework. We remain convinced that the OECD (and the IF) is the best, and possibly the only forum, in which such an agreement can be reached.
- Second, given the differing impacts of these proposals on diverse sectors, it is not surprising that our membership was unable to reach a consensus view on certain topics (e.g., the appropriateness and scope of the “consumer facing” inclusion). However, where possible, we have tried to express consensus views, and where that is not possible, at least to lay out issues that all our members agree will need to be considered in subsequent work on these proposals.
- Third, we are concerned that the slightly elastic use of formerly well-defined terms may confuse the discussion rather than clarify it. For example, the use of the terms “routine” and “residual” profit has led those familiar with transfer pricing to consider ways to calculate those amounts. But, in fact, such calculations are unnecessary because Amount A is aimed at reallocating profits above a certain mechanical threshold, and, likewise, Amount B is aimed at reallocating profits by way of a fixed return. It might be simpler to acknowledge this, in order to then aid the search for the principles underlying these new approaches.



- Finally, our members do wish to make clear that our genuine commitment to engage constructively in this process, is, nevertheless, not an unconditional commitment to support any result that is reached. *Business at OECD* remains committed to its *Business Principles for Addressing the Tax Challenges of the Digitalizing Economy* and would be unlikely to support the project in the event of substantial divergence from those principles.

In terms of our substantive comments, I would like to draw your attention to a number of issues dealt with at more length in our detailed comments below.

- There remains a need for clear articulation of the principles underlying Amounts A, B and C. Each of these is different, and no one formulation can cover all three. Furthermore, each operate in different ways and with different results. In order to promote a broad and deep understanding, and to prevent divergences in interpretation and administration between countries (not to mention the application of different and changing formulas), clear underlying principles supporting each approach taken must be articulated.
- Certain of the key terms in Pillar 1 are new (e.g., “consumer facing”; “routine marketing and distribution functions”; together with references to different types of “segmentation”), and make still more important the need for definitional clarity to promote certainty for taxpayers and tax authorities. These definitions must be specific enough that taxpayers don’t bear the onus of self-defining under unclear rules. However, at the same time, a balance must be struck so that not every available governmental resource is devoted to, essentially, “boiling the ocean”.
- Given both the newness and potentially complexity of the “Unified Approach”, there must be a relentless focus on administrative simplicity/simplification. There is nothing exclusive about this list, but all the measures below are aimed not just at making the system less onerous for taxpayers, but also for governments (especially those of less developed economies):
  - The possibility of paying amounts owing under Amount A (especially de minimis amounts) to tax authorities of the group parent’s jurisdiction for onward transmission;
  - Allowing the filing of a multi-country Amount A return with group parent’s jurisdiction;
  - Sole use of the group parent’s jurisdiction own accounting standards, rather than those of every country entitled to an Amount A sum;
  - Possibility of coordinated audits led by the jurisdiction of the group’s parent.
- As a continuation of the previous point, but of particular importance, the nexus rules must be designed to try to prevent spill overs between Article 5 and new nexus rules, as well as spill over of the lower nexus standard into non-tax areas.
- In order to make the “Unified Approach” unified, more detailed rules must eliminate overlaps between Amounts A, B and C that would otherwise result in clashing principles and double taxation:
  - Amounts A and C could well tax the same profit (once based on exceeding a certain threshold, followed by an allocation based on sales/revenue; a second time as a result above “baseline” activity in a country). This is further complicated by the fact that the double taxation may take place in different countries (once on revenue base; once on activity).
  - Amounts B and C could also tax the same income depending on the level of Amount B and the relation that bears to the true level of activity in a country.



- There should be an equal focus on dispute resolution as a key part of project, and this must move at the same time as other key items. Furthermore, while an ultimate resolution mechanism involving something like mandatory binding arbitration will be important, substantive changes to MAP procedure will also be crucial.
- Finally, it is worth emphasizing that while we support ICAP and Joint Audits, and other dispute prevention mechanisms, the best form of dispute prevention is clear, understandable, and, where necessary, detailed rules that are widely agreed to.

I want to close with one final comment. While the Secretariat has not often used this term, there is an increasing tendency to refer to the entire project as “BEPS 2.0”. At least in relation to Pillar 1, however, that language is quite unhelpful and, indeed, misleading. Pillar 1 is – should be – about constructing a new tax system for new business models and a new economy. That needs to be a tax system which takes account of the way business is working (and even more importantly, will come to work); a system that allows governments to raise money based on new value-creating forms of activity; but also a system that fosters and enhances cross-border trade and investment and creates inclusive growth. To impose an anti-avoidance narrative on Pillar 1 could frustrate that. We strongly encourage the OECD to help us prevent Pillar 1 from being locked into an anti-avoidance box. There is much more at stake here.

Again, we thank you for the opportunity to comment on this important proposal, and look forward to further engagement at the public consultation and beyond.

Sincerely,

A handwritten signature in black ink that reads "Will Morris".

Will Morris  
Chair, Taxation and Fiscal Policy Committee,  
*Business at OECD* (BIAC)



## Executive Summary

1. *Business at OECD* appreciates the opportunity to provide feedback on the Secretariat’s proposed “Unified Approach” for Pillar 1. As the voice of business at the OECD, we aim for our comments to be constructive, both in supporting and challenging elements of the proposal where our members express strong unanimity, as well as in highlighting differences of opinion on the challenges where views diverge.
2. The Secretariat’s proposed “Unified Approach” continues discussion on a consensus-based solution to aspects of the international tax system that result in outcomes that not all countries consider appropriate in a globalized and digitalized economy. Unilateral measures seeking to deal with these challenges are causing uncertainty and investment caution, and we endorse a multilateral agreement that addresses the concerns in a consistent manner.
3. We strongly believe that the long-term success of this endeavour can create a stable and certain environment for both taxpayers and tax authorities, but in order to do so, the entire framework must be rooted in widely accepted principles. Otherwise, the benefits of the agreement will be short-lived; any number of political pressures can arise in individual countries or regions, which will result in pressure to diverge from the international consensus and anchoring points – rooted in clear principles – are required to ensure coherency. Therefore, we encourage the Inclusive Framework to more clearly link the elements contained in Pillar 1 (and subsequently those in Pillar 2) to recognized economic and tax policy principles.
4. On 21 January 2019, *Business at OECD* published *Business Principles for Addressing the Tax Challenges of the Digitalizing Economy* (“Business Principles”). This list of 11 policy recommendations should, we urge, continue to be considered in developing modifications to the underlying international taxation norms for the modern digitalizing economy. The core principles outlined in the Ottawa Taxation Framework (which are referenced in our Business Principles) should also continue to be adhered to in this process.
5. It is also critical for the Secretariat to make public an impact assessment to allow for input by the business community and informed decision making by Inclusive Framework members. Anticipated rule changes will undoubtedly have an impact on national tax revenues, employment, business investment, business models, and tax compliance, and these potential adjustments need to have their economic effect properly evaluated in a transparent manner.
6. Reform of the international tax rules is needed, but should be focused and proportionate. Rule modifications should allow market countries to obtain an appropriate allocation of profits for profit-generating revenues arising without (or limited) physical presence, without making significant changes to how current rules work regarding traditional taxing rights in jurisdictions involving physical presence for the scenarios where this is delivering a stable and agreed policy outcome.
7. One of the driving forces behind finding a consensus approach within the Inclusive Framework is the wish to avoid a multiplicity of unilateral measures. Any agreed proposal



must clearly mandate the removal of any existing or contemplated unilateral measures (including revenues taxes such as Digital Service Taxes, and taxes that deem profits to arise where they are already allocated and taxable elsewhere – such as the UK’s Offshore Receipts Rules, or Diverted Profit Taxes) at the same time that the new agreement is reached, and prohibit future enactment of such arrangements.

8. *Business at OECD* supports in principle the concept of a separate and proportionate nexus rule, although some members note that the policy objectives could be achieved without “nexus” (in the traditional sense) and encourage greater cooperation between countries to deliver this. In any event, as written, the nexus proposal does not make clear that a new taxing right in countries where a company has no physical presence under the traditional PE concept is strictly limited to determining and collecting taxes allocated under Amount A. The stated intent to avoid spill over effects from a new nexus rule should be clearly supported with language (drawn up in conjunction with the appropriate non-tax public international law experts) that limits the ability of jurisdictions to use this rule for anything other than Amount A tax purposes (including other taxes, income or non-income, as well as non-tax issues).
9. The treatment of losses is of great importance to the business community, and the issue of loss recognition and allocation needs to be further clarified. If not addressed adequately, double taxation will be inevitable, which needs to be avoided.
10. The use of formulary approaches to identify the Amounts A and B and to allocate Amount A must be implemented in a manner that will not lead to more complexity – for instance, if countries receiving a reallocated portion of profits can implement different rules (to other countries) for application, verification, and auditing of such a part. *Business at OECD* cannot see the steps as described in the Consultation Draft leading to a simple and administrable approach if countries do not agree multilaterally up front, not only on the allocation approach, but also on measurement, review and verification approaches, as well as offsetting mechanisms with existing corporate tax payments.
11. Tools to effectively prevent and resolve protracted disputes regarding Amount A allocations are needed (in addition to Amounts B and C). While joint audits and ICAP have shown some success in their limited pilot phases, neither is yet sufficiently scalable to allow for effective resolution of disputes over profit allocation. *Business at OECD* strongly believes that a robust system providing mandatory and binding resolution must be a component of any agreed Pillar 1 framework to resolve the inevitable disagreements that will arise under these new rules, ideally with a centralized administrative process (i.e. one-stop shop). Mandatory binding arbitration in particular is needed to ensure that mutual agreement procedures (MAP) work properly by incentivizing timely government consideration.
12. We are pleased to provide input below on the issues requested for public comment in the Consultation Document.



## Introduction: Benchmarking the “Unified Approach” against our Business Principles

13. In January 2019, *Business at OECD* published 11 principles<sup>1</sup> that we consider it imperative to respect in addressing the tax challenges of the digitalization of the economy. While recognizing that the current Pillar 1 proposals must be viewed alongside those in relation to the evolving Pillar 2, we have taken this opportunity to provide an initial benchmarking of the Pillar 1 “Unified Approach” against these Business Principles to demonstrate the areas of greatest alignment and challenge.

Principle	Score	Comment	
Be based on long-standing and well-founded underlying principles of international taxation		The proposal, while nominally seeking to adhere to the arm’s length principle in certain circumstances (Amount C and potentially Amount B, if the formula approximates to the arm’s length principle), in reality represents a dramatic departure from foundational transfer pricing rules and creates a new basis for nexus not based on physical presence. Therefore, depending on the interactions between Amounts A, B and C, as well as their relative scope, this principle could also be marked red.	
Not ring-fence the digital economy		The proposal appears to ring-fence some portion of the digital economy.	
Respect the Ottawa Taxation Framework principles		Neutrality	No explicit discrimination of digital or remote sales.
		Efficiency	Unclear at this stage; opportunities exist.
		Certainty	Not at this time.
		Simplicity	Not at this time.
		Effectiveness	Unclear at this stage.
		Fairness	Opportunities for avoidance appear to be limited
Flexibility	The proposals should keep pace with changing business models; formulaic elements and monetary thresholds reduce flexibility.		
Be grounded in the concept of value creation		The reallocation of taxing rights under Amount A, and likely Amount B as well, appears arbitrary.	
Reduce instances of double taxation		We acknowledge the intention to prevent double taxation, but elements of the current proposal will increase the opportunities for double taxation to arise; it is critical that the proposed elements to eliminate it in new and existing cross-border allocations are strengthened. In addition, existing unilateral measures must be clearly removed and future conflicting regimes strongly prevented.	
Be introduced as a comprehensive package		The proposal commits to implementation as a comprehensive package (alongside an evolving Pillar 2 proposal) and also notes that coordination in entry into force is required. However, dispute resolution and action on unilateral measures must also be included.	
Be reflected in model treaties and commentary		The proposal recognizes that effective multilateral implementation requires robust mechanisms (such as treaty changes or other instruments).	

<sup>1</sup> See Business at OECD, *Business Principles for Addressing the Tax Challenges of the Digitalizing Economy* (Jan 2019), <http://biac.org/wp-content/uploads/2019/01/FINAL-2019-01-21-Business-at-OECD-Digital-Principles-Position-Paper.pdf>.



Provide tax certainty for taxpayers and tax administrations, including strong dispute resolution mechanisms		The proposal is still too broad to give taxpayers certainty.
Have global agreement		N/A at this time.
Minimize the administrative burden on taxpayers and tax administrations		The proposal recognizes some of the administrative challenges that it will cause, however, much more detail (and creative thinking) will be required to address these.
Be developed through inclusive consultation with all businesses and other stakeholders		We welcome the opportunity to comment on the proposals, but regret that no economic impact assignment is available for a complete analysis.

14. Overall, there is a general concern that although the Consultation Document repeatedly states that the goal of the “Unified Approach” is to retain the arm’s length standard in those areas where it works well, the combined results of the various proposed elements leads to a distinct departure from the arm’s length standard overall.

### Section 1. Scope

15. While our members do not have a single view on the distinction between “digitalized and consumer facing” businesses, and “other” businesses, it is clear a key challenge lies in defining “consumer facing”. From the feedback we received, there is high business uncertainty as to which business models, industries, and segments might be considered within scope. This fundamental concern is a serious distraction from the critical task of determining the underlying rationale for an additional modest profit allocation to market jurisdictions in some cases.

16. We understand that the term “consumer facing” was introduced as a common element between the three initial approaches (active user participation, marketing intangibles, and significant economic presence), which all suggest that the “consumers” (or users) of products or a strong branding create a certain value for a company in a market jurisdiction which contributes toward the generation of profits. These seemingly distinct elements could be manifested through:

- a. “Consumer interaction” would be manifested for instance by websites with active user input;
- b. Strong branding and marketing support (the definition or threshold of which is unclear) from remote locations could entice consumers/user to buy those products versus similar domestically produced ones.

17. Since a lack of clear definition will allow participating countries to implement the solution in different manners, it will be imperative, in the absence of a self-executing principle, to conduct a substantial line drawing exercise in order to avoid uncertainty (and double taxation). We believe that it is difficult if not impossible to define “consumer facing” even using concrete “interaction” elements that are objective as possible -- e.g. the presence of a loyalty program, the maintenance of a local website with consumer feedback, targeted (rather than generic) advertising, etc.



18. The proposal seeks to differentiate between consumers and customers. While the consumer is expected to be the individual end-user of one of the goods/services contributing to the supply chain, a customer includes any recipient of goods / such services, who may or may not be consuming the good/service, and in either case may not be individuals (i.e. they may be other businesses or organizations such as governments). In other cases, intermediaries or individuals may consume part of the good/service, or modify it to varying degrees to add further value to the end consumer. In other cases still (and particularly in the case of governments) the customer may pay for the good/service, but rather pay for it on behalf of those who consume it.
19. The fact that different countries have differing definitions of consumer for domestic non-tax laws is testament to these difficulties, and in order to be coherent, a consistent definition must be used for tax purposes. More clarity is required on whether and how customers (who are not individual end-users consuming in a personal capacity) will be included within the scope of the solution. This is critical for coherent development across all workstreams, including profit allocation and nexus.
20. In addition, where the consumer interaction strategies are localized on a country or regional basis, a solution must allow bifurcation in determining the “in scope” amounts available to be allocated to each country (e.g. businesses with strong domestic brands interacting with foreign consumers where the same products or services are offered, but delivered through more localized strategies).
21. Similarly, to the extent that business-to-business (“B2B”) transactions occur with no direct consumer interaction element, great care must be taken to avoid complexity. It is unclear to us whether the proposal is seeking to target businesses whose products and services actually end up in the hands of consumers (regardless of whether that was sought or not), or those businesses that have (successfully or unsuccessfully) sought to secure end consumers’ direct/indirect utilization. Each alternative would require differing approaches.
22. Any look through provision that requires tracing direct sales to end users or consumers stands to introduce significant complexity for both taxpayers and tax authorities (which we will discuss further in the following section).
23. Attempts to draw the line between what is “consumer facing” versus what is not could lead to discussions that are neither helpful for companies nor for tax administrations and make the solution impossible to administer. For example:
  - a. *A semiconductor may be manufactured by a taxpayer in one country and incorporated elsewhere by an unrelated party into a new consumer device, such as a smart phone or computer. This new device has been physically and materially changed through the manufacturing process by unrelated entities and does not represent a consumer facing endeavour. While marketing may have some role in the sales process, it is less important as these products are incorporated/transformed into other products or sold in bulk to a third party (company or individual end user), and rarely (if ever) bought individually by consumers. As such, the taxpayer generally does not know where the ultimate use of that product is occurring or that the product will indeed be used for personal consumption. Without the ability to know the destination of the semiconductor, it is impossible to determine whether it has*





*been supplied for consumer products.*

- b. *In the energy sector, consumer sales can exist but are very dependent on local infrastructures and often regulated. The company could have a customer friendly local website, collect data from customers through smart meters to improve their consumption, and may have loyalty programs. However, as the energy supplier could be subject to price regulation, there might be no additional profit from those elements.*
24. In order to find the right balance between administrative effort and potential amount of profit reallocation, we understand that the “Unified Approach” proposes to limit the scope to large MNEs (perhaps those that have more than €750 million in worldwide revenues, consistent with the country-by-country reporting rules, as is implied in the discussion document). In our opinion, this needs to be further detailed: would this threshold be applicable to the MNE in total, or only if the “in-scope” activities as defined above exceed this number? Would sales by non-consolidated affiliates (e.g. minority joint-venture stakes) be included?
25. If the €750 million in total worldwide revenues threshold is agreed, a significant number of groups would be in scope, and the introduction of administrative simplification mechanisms would be vital for both tax administrations and businesses to be able to comply. The introduction of a one stop shop for compliance could be a prime example (e.g. filing with the home country like for country-by-country reporting); payment of de minimis amounts to the home country for onward distribution; limit audits of any agreed formula to the home country or having home country leadership over a single joint audit). This issue also cuts across the local nexus challenges, and as such, it is discussed further in the next section.
26. One further direction to limit the number of companies in scope would be the introduction of a de minimis rule around the amount of cross-border sales versus domestic sales that the business generates. Companies that have their entire or most of their value chain in a country should not be impacted by rules that seek to reallocate profits between countries. As such, the Inclusive Framework might consider introducing as a further criterion that at least x% of an MNE’s sale needs to be abroad, or disregard local business activity altogether.
27. We strongly encourage the Inclusive Framework to adopt measures limiting the number of companies under the scope of Pillar 1. Without identifying specific carve-out candidates for exclusion, we note that some industries do not present the same high profit margin and remote selling profile that the Pillar 1 “Unified Approach” seems to be targeting. Thus, their inclusion would likely lead to limited reallocation of profits (either in absolute terms or relative to the compliance burden to them and tax administrations). Therefore, a way to provide relief to the business community and limit the scope of Pillar 1 could be to exempt companies, which on a consolidated group basis do not have aggregate profit margins in excess of a threshold percentage (which may or may not be the same as the percentage used to calculate Amount A).
28. In addition, we note that some enterprises are exempt from taxation in some countries because of their charitable (or Not-For-Profit) status. We acknowledge that there would be challenges in all countries agreeing to the scope of such exclusion (as they will have different views on the breadth of such charitable exemptions). However, such enterprises would be particularly sensitive to reallocations if there were no similar exemptions applying in market



countries as to the surrendering jurisdiction, and it may not be aligned with the policy objectives to disincentivize their international interactions.

29. *Thus, in terms of our Business Principles, we are concerned that at present, the scope discussion under the “Unified Approach” may not meet those that relate to well-founded underlying principles, avoiding ring-fencing, being grounded in the concept of value creation, providing tax certainty, minimizing administrative burden, and being developed through inclusive consultation.*

## Section 2. New Nexus

30. It is imperative that the agreed solution enables countries to receive an allocation of tax under the new system without creating “nexus” in the traditional sense (and incurring direct tax compliance costs and facing other associated legal challenges with the establishment of “nexus”). Although the discussion draft refers to avoiding spill over effects from the creation of a separate nexus standard, the “Unified Approach” must more robustly articulate that this new nexus is only to be used for Amount A purposes. It must not give rise to additional filing or tax requirements for other taxes (income or non-income tax), as well as non-tax areas (such as environmental, labour, etc.). Similarly, no exit taxes should be levied in the transition to the new system.
31. The actual degree of interaction with a market required to trigger that tax liability would be a less sensitive question where such unintended non-tax consequences are avoided. Such a solution requires greater cooperation between tax administrations, but it would reduce their own compliance burdens and increase the tax that they are able to collect through negotiation with a large number of individual taxpayers.

### Simplicity and Thresholds

32. Notwithstanding this broader point, we appreciate that even if an administratively simplified solution can be achieved, limiting the administrative cost to tax administrations and taxpayers alike may require local thresholds to be set. As noted above with regard to the global sales threshold scope limitation, as a general matter we believe that administrative simplification is a far more important objective than seeking to set monetary or activity-based thresholds (which will, by nature, diverge as a result of countries’ different sizes and tax administration approaches). If the Inclusive Framework participants cannot agree to a sufficient level of cooperation to make combined global administration practicable, then sensible and consistent local thresholds will be required.
33. Country specific sales thresholds could be a reasonable means to avoid administrative costs that are likely to outweigh the potential revenue collected by the market jurisdiction. We would recommend that clarity be brought to this aspect of the proposed rule. For instance, the Inclusive Framework could adopt two (or more) threshold amounts – e.g. one each for economies with GDP above and below a certain threshold. Potentially, the introduction of a floor (i.e. regardless of the applicable numerical threshold, if a company’s sales into a jurisdiction represent less than X% of its global profits, no nexus for Amount A should be created) could also avoid burdensome administrative compliance efforts that are more than the additional revenue generated to the market jurisdiction. However, we recognize the challenges in this approach (such as dealing with inflation/exchange rates, and sales



hovering near the threshold).

## Determination concerns

34. Where companies do not use in-house distribution but rather third parties (e.g. Joint Ventures or third party distributors), it might be impossible for them to determine in which country the end consumer is located, since they would only be able to track sales to that third-party distribution entity. This is also the case with respect to embedded products. One example is the free movement of goods in the EU, where distributors/customers could buy centrally in one country and then sell to consumers in all other countries. It is questionable whether they could be obliged to provide this data to the selling company.
35. *In terms of our Business Principles, we believe that the new nexus rule under the “Unified Approach” should better endeavour to reduce double taxation, provide tax certainty, and minimize administrative burden.*

## **Section 3. Calculating Amount A group profits**

36. Although not unanimous, many of our members believe that Amount A should be computed using group financials on earnings before tax (EBT) level.<sup>2</sup> While those are normally published for public companies, there is a greater compliance burden to calculate them for private companies. In any event, the interaction with other allowable expenses and tax allowances (e.g. tax incentives, interest restrictions) would need to be considered to ensure the reallocation is coherent with such existing rules.
37. Financial accounts are meant to give a financial picture to investors, not data to tax authorities. Similarly, business segmentation is often used for internal control purposes and business reporting requirements rather than to provide an accurate view of profitability for fiscal purpose.
38. Given there should be no base erosion concerns at a group-consolidated level, adjustments to a group’s financial statements should be limited. Certain differences may need to be recognized for unusual non-recurring items (such as dividends, capital gains or business disposals), for other changes in equity not recognized directly as income, or material timing differences. In particular, we note that the greater the number of adjustments required, the more arbitrary the allocation will be for businesses at different stages of their respective life cycles when the new rules come into force. We acknowledge though that this cannot be avoided entirely: for R&D intensive businesses, expenses are incurred many years before sales take place and so give an illusion of returns in excess of a routine amount, while for the insurance business, revenues (premiums) are received upfront, while expenses (claims) can be incurred later.
39. An alternative to limiting book-to-tax adjustments would be the introduction of globally applicable book-to-tax accounting rules although we acknowledge that this is probably unrealistic within the scope of Pillar 1.
40. While a taxpayer may always use their global accounts as the starting point for making the Amount A calculation, a taxpayer who reports financials on a business line or regional basis

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<sup>2</sup> A number of members did favor using Operating Margin.



should be able to use these global financial accounts for the purpose of calculating Amount A, as those represent business operations/management rather than tax structuring, even if this is only as a first step. Concerns around such an approach could be mitigated by using a multi-year average, which also addresses some of the issues arising from the allocation of losses and cyclical businesses. It should be noted however that many companies only segment at the gross margin level, so it will be necessary to decide how to allocate common expenses. Group expenses and overhead amounts should be allocated among the entity's business line or regional grouping.

41. This proposal will result in some non-uniformity within industries, as not all business will use segmentation, based on management decisions. In addition, segmentation may add unnecessary complications where the results do not materially differ from the overall group accounts (if for instance the business lines or regions have more or less the same profit structure as the overall group, segmentation may not be warranted).
42. As alluded to above, business segmentation will rarely reflect division between those product/service lines that are "consumer facing" versus those that are not, although it may be useful as an initial filter (or gateway) for out-of-scope segments, and assist in identifying non-complementary areas of the business that should be treated separately in any event. It will require attention to identify in-scope revenues without introducing overly burdensome reporting rules.
43. One solution could be that companies, who know their specific business model best, can propose a segmentation that would be most appropriate. In line with the one-stop shop proposal, the home country tax authority could then audit this segmentation and, if approved, the company would have to sign up for a certain period to use such segmentation (absent any significant business restructuring or M&A).
44. The Inclusive Framework should conduct widespread engagement with business financial accounting experts in order to best construct a reporting framework that minimizes business disruption and complexity.
45. *In terms of our Business Principles, we believe that the group profit calculation under the "Unified Approach" should better endeavour to stick to well-founded underlying principles, respect the Ottawa Taxation Framework objectives, provide tax certainty, minimize administrative burden, and be developed through inclusive consultation.*

#### Section 4. Determining Amount A

46. Amount A is defined as the deemed residual or excess profit after all other functions in the value chain have received their deemed "routine" remuneration. Given that distribution is part of those functions, the close link between Amount A and Amounts B plus C is evident and warrants careful scrutiny.
47. If a formula uses a percentage of sales (or other metrics such as return on assets for industries more typically measured against such metrics) for the total "routine" remuneration, it should be ideally calculated based on arm's length parameters. However, given that this would most probably not result in one single number as it is planned in the "Unified Approach" (even not per industry), such formula would mean a conscious decision to depart from the arm's length principle. As a consequence, it may encourage some



businesses to target an equivalent return per arm's length principle (either through transfer pricing policies or reallocation of activities, e.g. reduction of marketing and distribution functions to baseline scope) in order to reduce the complexity of the reallocations required. This may increase the returns to countries currently receiving less than the agreed percentage, and put pressure on those that would otherwise be receiving additional returns through Amount C (or Amount B depending upon the rules).

48. Some members believe that only using sales as the basis for allocation (i.e. allocation key) fails to look on all dimensions of value generation. Looking at other factors – such as salaries and/or tangible assets – could provide a better reflection of where value generating activity occurs and how profits could be apportioned. This may more accurately reflect actual activity within a jurisdiction. Others prefer the relative simplicity of sales thresholds. In order for the solution to be widely administrable, safe harbours should therefore be considered. (The number of differing views on a relatively “simple” point such as the allocation approach shows the level of complexity and international agreement required to arrive at a true unified approach without double taxation.)
49. We strongly believe that market jurisdictions should only receive allocated Amount A profits if the country in which residual profits arise under current transfer pricing rules has signed up to the Pillar 1 framework and utilizes the centralized dispute resolution mechanisms contemplated in this proposal.
50. *In terms of our Business Principles, we are concerned that at present, the definition of Amount A under the “Unified Approach” may not meet those that relate to well-founded underlying principles, providing tax certainty, minimizing administrative burden, and being developed through inclusive consultation.*

## **Section 5. Eliminating double taxation in Amount A**

51. As noted in paragraph 65 of the Consultation Document, allocating amounts to market jurisdictions under Amounts A, B, and C will require close coordination to ensure that double counting is avoided. This is more of a challenge regarding identifying where the profits to be reallocated come “from” than identifying where they should be allocated “to”; i.e. the fungibility of accounting profits being overlaid onto a transactional system. This issue is particularly evident in business models where intellectual property is not centralized in one entity (i.e. most large MNE business models) and where rather both intellectual property and functions generating more than routine returns are dispersed widely across the group.
52. It also should be made clear that the existence of Amounts A and C are not co-dependent (i.e. clarify that both amounts are not automatically applicable just because one element is present); market jurisdictions must independently satisfy for each amount the applicable nexus rule and sub-part requirements.
53. Double taxation risks occur at multiple places in the existing system (through either differences in law or interpretation between tax administrations) and the overlay of an additional reallocation will increase the ways in which it can arise. This may be where countries disagree over the calculation of Amount A (including their allocation of that Amount to them), or where they disagree over where Amount A should be taken from. Clear and objective agreements will be required on both sides.



54. The fact that Amount A is a fungible amount comprising a portion of residual returns that may be recognized in a range of countries (or technically not anywhere, where accounting profits differ to taxable profits), the second double taxation challenge could be addressed in one of two ways:
- a. Capping the allocation to each market that already recognizes residual profits (on the basis that this would ultimately be reallocation of a portion of the same profit); or
  - b. Ensuring a portion of the total credit is granted across all entities already recognizing profits in excess of routine returns (in line with pre-agreed formulae, such as share of total taxable profits – which would presumably be highest where the majority of any above normal returns are allocated).

The latter would be more complex and result in adjustments in more entities, but the result would be comprehensive double taxation relief.

55. A majority of members believe in having the MNE parent treated as the relevant taxpayer for Amount A. This produces administrative simplicity regarding Amount A, especially if the distribution of Amount A would happen via the one stop shop concept as described above. However, in case segmentation applies, the relevant taxpayer could be the surrender entity of the segment (either business line or regional). Given the different viewpoints of our members, flexibility in this question seems to be paramount to ensure no uneconomic results occur.
56. Based on feedback from members, it does not appear that either a credit or an exemption scheme would effectively work to avoid double taxation with respect to Amount A. For example, tax credits will not work in instances of a territorial jurisdiction, low profit margin companies, or periodic loss-making companies.
57. Therefore, we recommend the Inclusive Framework consider a method that allows for a deduction (i.e. a correlative adjustment) in the surrender jurisdiction of the part of Amount A profit that is allocated out.
58. The recognition and utilization of losses is a particularly challenging area more broadly still. If business lines are only in scope if (or once) they are generating a high profit margin, this would seem to exclude the allocation of losses. However, if the jurisdiction that generated the losses is not entitled to all of the related profits where they are then generated, then this jurisdiction is effectively funding the other territories. It may even be the case that the losses are then never fully utilized when they might otherwise have been (thus increasing the tax cost of the investment, and delivering no tax over the life of the investment to the jurisdiction in which the investment took place). There would be two ways to partially (but not fully in economic terms) resolve this outcome:
- a. Ensure that no reallocation happens before related losses incurred are fully extinguished.
  - b. Reallocate the existing losses across jurisdictions at the point where profits become substantial enough for them to be in scope.

We believe that option a. would be the simplest to deliver, as option b. would require new loss utilization rules in each country and the allocation would be arbitrary, as profit levels (and the markets from which revenues are earned) will change over time. However, even option a. would be unlikely to deliver an economically equitable allocation of both profits



and losses to the same jurisdictions over the life of an investment.

59. A few members have commented that royalty income treated as residual profit may cause problems in obtaining double tax relief for withholding taxes, and in substance already represents an allocation to the source country. There is also some reluctance toward the use of a withholding tax mechanism as it would require determining who would withhold tax (which can be especially problematic when there is no related party in a jurisdiction), as well as create administrative burdens in receiving refunds or relief.

60. *In terms of our Business Principles, we are concerned that at present, the attempt to eliminate double taxation under the “Unified Approach” may not meet those that relate to well-founded underlying principles, providing tax certainty, minimizing administrative burden, and being developed through inclusive consultation.*

## **Section 6. Amount B**

61. As with other aspects of the Pillar 1 “Unified Approach”, there is lack of clarity regarding how Amount B will be implemented in practice. As the intent of this part of the profit allocation mechanism is to determine and award profit tied to routine marketing and distribution activities, it is critical to have clear definitions of what activities are to be considered as “routine”, again with the possibility of a list of activities that are specifically to be excluded from this determination.

62. Members differed on the measure to use for determining the quantum of the return. Some favoured a single fixed percentage; others preferred a fixed percentage varying by industry. However, all agreed that it should be impossible for countries to unilaterally change Amount B. We would note again that while the calculation of such percentages should be based on arm’s length returns, the application of one number (even per industry) would mean a conscious decision to depart from the arm’s length principle.

63. There is also a concern that using a simplifying convention, such as a fixed percentage formula, can result in a calculated amount that is larger than the global or regional profit margin of a business. This is particularly evident for low margin businesses. In such a case, the foreign entity with a local taxable presence faces a tax on gross revenue while domestic competition only has a tax on net revenue. This outcome could be viewed as discriminatory and protectionist. It may be possible to address this concern through correlative adjustments.

64. Some members are concerned that risk-bearing distributors, because of the structure of the arrangement, will have already caused profits targeted by Amount B to be earned in the jurisdiction, and so there is a need to avoid duplication and redundancy in such situations.

65. The impact of such change in (deemed) remuneration of distributors will also have implications beyond direct taxes that should not be overlooked. Customs and indirect taxes are the most obvious examples. If the profit margin of an existing distributor would be increased, transfer prices would decrease with a subsequent reduction in customs and indirect taxes.

66. *In terms of our Business Principles, we are concerned that the definition of Amount B under the “Unified Approach” may not meet those that relate to well-founded underlying*



*principles, providing tax certainty, minimizing administrative burden, and being developed through inclusive consultation.*

## Section 7. Amount C / Dispute Prevention/Resolution

67. The interaction of the formulae in Amounts A and B and the proposed mechanics of Amount C could create significant instances of double taxation, which the “Unified Approach” does not specifically address.
68. Similar to Amount B, the definition of Amount C needs to be precise: is it everything outside “baseline marketing and distribution”? Or only specific parts of the value chain? For instance, if a company provided marketing and distribution for a product from abroad, but also the full value chain for a domestic product, and the marketing and distribution functions were shared, how would Amount B be apportioned? The additional functionality may result in tax disputes over whether it relates to baseline activities and/or the level of additional profit that should be earned on an arm’s length basis under traditional transfer pricing methods.
69. The interaction of Amount C and Amount A also needs further consideration. Guidance is required to understand how an outcome under Amount C will affect the allocation of profit to market jurisdiction under Amount A in order to avoid double taxation. Equally, there is a need to ensure that allocation of Amounts A, B, and C to market jurisdictions does not leave the investor with a return below what can be reasonably considered routine for its functions, assets, and risks.
70. There is also a need to distinguish between clearly valid claims for Amount C (for instance when there are additional functions to marketing and distribution), and questionable claims (for instance on the interpretation of whether a company does baseline or “baseline plus” marketing and distribution). It might also be warranted that in the case where a country claims an Amount C, all functions of the company (both routine and non-routine) would be analysed under the arm’s length principle in order to provide for the most correct result, i.e. the formulaic apportionment of Amount B would be eliminated.
71. Because disagreement over any Amount A allocation will inevitably affect more than just two jurisdictions, a multilateral solution is needed.
72. Members report that APAs generally are an effective means to avoid dispute, but the practical reality of a lengthy negotiation process limits the utility of such a document, particularly as multilateral APAs would be necessary under the “Unified Approach”. (A number of our members have already told us, that countries are holding back in current APA negotiations based upon uncertainty as to the outcome of this project.)
73. Any set of rules introduced with respect to mandatory binding arbitration should be robust, transparent, and contain low thresholds so that taxpayers could access mandatory binding arbitration when disputes relating to the calculation of Amounts A, B and C arise between implicated jurisdictions. The use of mandatory binding arbitration is necessary to help MAP function in its intended manner by incentivizing governments to quickly come to agreement on bi-/multilateral issues. In particular, a short time frame of only several months would be highly desirable in order to ensure swift resolution of disputes. Other MAP improvements should include uniform procedures making it much harder for countries to refuse to honour





their MAP obligations, as well as directly inviting the taxpayer to participate once the process has started.

74. *In terms of our Business Principles, we believe that the “Unified Approach’s” dispute resolution tools should better endeavour to stick to well-founded underlying principles, provide tax certainty, minimize administrative burden, and be developed through inclusive consultation.*

## Section 8. Other comments

75. It will be imperative that all Inclusive Framework members ultimately participating in a final agreement must simultaneously and consistently implement the resulting principles in order to achieve tax certainty and eliminate the risk of double taxation.
76. In its October 2019 Secretary-General report to the G20 Finance Ministers,<sup>3</sup> the OECD noted that its preliminary impact assessment indicated that the anticipated combined effect of Pillars 1 and 2 would be to raise a significant amount of global tax revenues. On an individual basis, developing and less well-performing economies stand to benefit from proposed measures, while investment hubs and small advanced economies would lose tax base and revenue. Yet the report also states a belief that the aforementioned outcomes will not likely have a negative impact on business investment and would increase tax certainty.
77. These outcomes seem irreconcilable and further illustrate the need for a transparent process in which the business community and participating Inclusive Framework members can properly scrutinize any economic assumptions and anticipated results as they relate to effects on countries’ tax base, revenue collection, tax administration and compliance, and investment environment. The absence of this critical step in the process will only weaken the perceived legitimacy of any outcome and threaten commitment by members to the framework when future political concerns arise.
78. We recognize that the G20 has called for a final report on the combined digital economy project by the end of 2020, but the anticipated timeline is beyond ambitious and may result in serious long-term repercussions if rushed to achieve a political resolution. The numerous technical issues that have to be sorted out following acceptance of a high-level political agreement (which is not yet agreed) are too intricate and fundamental to be resolved in less than 12 months. We therefore believe it is critical that the Inclusive Framework work with the G20 to define the “implementation” period as one where rules are developed in depth, and agreed to extensively, rather than being (unrealistically) seen as a time when fully-defined laws can be brought into operation. This will be necessary to ensure all underlying components of a new framework are consistent, adequately defined, and fit into implementation measures to allow for transitioning and stability.

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<sup>3</sup> OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors, October 2019 (page 8 – “Preliminary findings of the Impact Assessment”).