

OECD hosts public consultation on proposed “unified approach” under Pillar One of BEPS 2.0 project

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Executive summary

On 21-22 November 2019, the Organisation for Economic Co-operation and Development (OECD) hosted a day and a half-long public consultation meeting on its document titled [Secretariat Proposal for a “Unified Approach” under Pillar One](#) (the Consultation Document), which was released by the OECD on 9 October 2019 in connection with the ongoing project on addressing the tax challenges of the digitalization of the economy. The OECD received over 300 written comment submissions on the Consultation Document. Representatives from business, labor groups, non-governmental organizations (NGOs), and academia participated in the consultation to discuss their perspectives. The consultation was chaired by the French and US government officials who serve as co-chairs of the OECD Task Force on the Digital Economy. Numerous government officials from the 135 jurisdictions participating in the project through the Inclusive Framework attended the consultation but did not make public comments during the sessions. EY submitted a [comment letter](#) and a global team from EY participated in the consultation.

At the outset of the sessions, the OECD Secretariat laid out the timeline for meetings of the Inclusive Framework at the end of January 2020 and in June/July 2020, and suggested that, at a minimum, a high-level political agreement on the Pillar One framework must be achieved by the January meeting.

In addition, at the end of the sessions, the Secretariat addressed the widespread concern that the proposal described in the Consultation Document lacks necessary details, referring to the current document as “an outline” and pledging that work will continue on filling in the details.

The discussion at the public consultation reflected what continues to be differences in understanding among stakeholders as to the overall objectives of Pillar One and the intended interaction of the three components of the proposed profit allocation mechanism – Amounts A, B and C – described in the Consultation Document.

Most business community representatives supported a go-slow approach, in recognition of the fact that the proposal involves fundamental changes to long-standing global tax norms that will have to be spelled out clearly and in detail. Other stakeholders – including business representatives who were concerned about the need for Digital Services Taxes (DSTs) to be dismantled and NGO representatives who viewed corporations as not paying their fair share of taxes – supported speed. However, the comments at the consultation generally reflected a common view that the existing global transfer pricing system, based on the arm’s-length principle, needs to be changed and should at least be augmented by some more formulaic rules.

Detailed discussion

The Consultation Document describing the Secretariat proposal for a “unified approach” under Pillar One includes sections addressing scope, a new nexus concept, and a three-tier mechanism for new profit allocation rules. The Consultation Document requested comments on a series of questions regarding these topics. The agenda for the public consultation sessions was organized around the questions in the Consultation Document.

Scope and nexus (Amount A)

Consistent with the discussion at the public consultation held in March 2019 on the OECD’s initial document introducing the Pillar One and Pillar Two proposals, participants in the November public consultation generally agreed that the global economy is changing and that global tax rules need to change with it. However, there was marked disagreement on what any new nexus and profit allocation rules under Pillar One should look like and what business activity should be covered by such rules.

While the Consultation Document identifies large, consumer facing companies as the target of the Pillar One proposal, some participants in the consultation, including many NGO representatives and some business representatives, advocated for a broader approach. Other commenters pointed out the difficulties in determining whether a multinational group with mixed business segments should be considered to be consumer facing or not.

One NGO representative commented that the manner in which the proposal is drafted creates significant pressure for carve outs and likely will result in only modest revenue gains, making the entire project not worth the effort. This commenter maintained that trying to draw a distinction between consumer facing and non-consumer facing businesses is flawed economically and that there is no justification for such a distinction, urging that all businesses be included in scope.

Financial services industry representatives supported a carve out for regulated financial services, maintaining that financial regulation requires banks and insurance companies to be located, and thus taxed, where their customers are and that current transfer pricing rules work well for the industry. A telecommunications company representative recommended a carve out on similar grounds, saying that the industry is locally regulated, pays local income taxes on local profits, and also pays industry specific taxes in their customer jurisdictions.

Calculation of group profits for Amount A

In the overview at the start of the sessions, the Secretariat explained that Amount A is the primary response to digitalization of the economy; that it applies to group profits, not single entity profits; and that it is intended to have as limited interaction as possible with the arm’s-length principle. The Secretariat acknowledged that Amount A and its application to situations involving the new nexus standard is still a work in progress. One problem to be worked out is the interaction with current transfer pricing rules, including the need to prevent any potential double taxation. The Secretariat also noted that Amount A would not be workable if every country could challenge the calculation and allocation of it after the fact, indicating that they are working to solve this.

Comments from business representatives stressed that certainty is key – how Amount A is calculated and allocated to market jurisdictions must be set in stone. A common theme from business representatives was that Amount A should be calculated by the parent company in a group and that the parent company should also be responsible for allocating Amount A among market jurisdictions. Many suggested that the tax administration in the parent company jurisdiction should be solely responsible for auditing the computation and allocation of Amount A.

Several business representatives raised questions regarding the determination of what entities and jurisdictions that Amount A should come from. Clear and workable rules for how much of Amount A is considered to come from each residual profit entity and jurisdiction are needed. The Consultation Document provides little information on how this mechanism should work.

Commenters generally supported the use of financial accounting data for calculating Amount A. It also was suggested that adjustments to the financial accounting data in calculating Amount A should be kept to a minimum. With respect to the calculation of Amount A, commenters also noted that rules will be needed to address timing differences. In addition, some suggested that losses and “extraordinary” one-time items should be excluded from the profit calculation on which Amount A is based. It was noted that special rules would be needed in dealing with the financial accounting data for groups that have minority shareholders.

Another comment made by several business representatives was that Amount A should only apply in situations where there is no group entity in the market country that is taking on risk and is taxed on its local profits.

One commenter expressed concern about the lack of consideration of synergies because the analysis underlying Amount A focuses on segmentation of business units/divisions.

Elimination of double taxation for Amount A

There was considerable preference expressed for tax base adjustments or exemption, rather than foreign tax credits, as the mechanism for addressing double taxation. The foreign tax credit mechanism was viewed as too complicated and potentially too limited to provide the necessary relief.

There was opposition to withholding mechanisms, with commenters arguing that it would be too difficult to identify withholding agents and to ensure that refunds would be provided where appropriate.

In connection with the discussion of double taxation, some business representatives noted that countries with DSTs in place must agree to withdraw them as part of any high-level political agreement on Pillar One, and that this should happen sooner rather than later.

Many business representatives reiterated the importance of providing for central coordination responsibility in the parent company's home country tax administration, covering computations, joint audits and dispute resolution procedures. Some commenters further suggested that the home country tax administration should act as a clearing house, including facilitating the remittance of taxes. Another suggestion was to set up a binding dispute resolution panel that can function agilely under its own administration and not as part of the conventional mutual agreement procedure.

Fixed remuneration (Amount B)

NGO representatives focused on Amount B as the most important aspect of the Secretariat proposal for developing countries and commented that it should apply more broadly than distribution activity.

Two business representatives presented detailed proposals for calculating Amount B, with a sliding scale based on operating margin and the inclusion of caps and floors. Several business community representatives suggested that the calculation of Amount B should be calibrated based on the size of the market. Other commenters suggested that further calibrations are also necessary, including adjustments for different region, industry, and business segments. Further, some suggested that existing data, pulled together and updated on a regular basis, could provide metrics for taxpayers and tax authorities to use for the Amount B calculation.

Commenters expressed different views on whether Amount B should be a safe harbor, a rebuttable presumption, a minimum amount, or a fixed amount. The need for a clearly defined list of activities to be considered as the baseline marketing and distribution functions for purposes on Amount B was also stressed.

The idea of a cap for the combination of Amounts A and B was explored, with the suggestion that this would allow any excess profit to remain with the entity that created the intangible property.

Some commenters suggested there would be no need for Amount C if Amount B is designed properly. They noted that Amount C is confusing and could be duplicative.

Dispute prevention and resolution (Amount C)

Most comments stressed that a lot more work needs to be put into defining each of the Amounts and describing the interaction among all three so that there is no overlap.

Implementation of new dispute resolution mechanisms in the form of mandatory binding arbitration was advocated by many business representatives, but NGO representatives generally expressed the view that binding arbitration was not acceptable for developing countries.

In addition to dispute resolution mechanisms, business representatives also stressed the equally important matter of improving dispute prevention by providing a framework that accomplishes simplification and certainty.

Implications

The Secretariat proposal outlined in the Consultation Document does not represent the consensus view of the jurisdictions participating in the Inclusive Framework but was developed in an effort to facilitate negotiations among countries so that an agreement can be reached. Stakeholders who commented during the public consultation expressed divergent views on the proposal, but many commenters cited the need for more details to be fleshed out.

The discussion at the Public Consultation underscored the breadth of the international tax changes being contemplated - changes that will have implications well beyond digital businesses and business models.

It is important for companies to continue to follow these developments closely as they unfold in the coming months. Companies should consider taking the opportunity to participate in future consultations or otherwise engaging with OECD and country policymakers on the design of the new rules. Companies also should begin to evaluate the potential impact of these changes on their tax profile.

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