19 October 2020

Global Tax Alert

OECD releases BEPS 2.0 Pillar One Blueprint and invites public comments

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Executive summary

On 12 October 2020, the Organisation for Economic Co-operation and Development (OECD) released a series of major documents in connection with the ongoing G20/OECD project titled "Addressing the Tax Challenges of the Digitalisation of the Economy" (the BEPS 2.0 project). These documents include the long-awaited report on the Pillar One Blueprint (the Blueprint). The aim of Pillar One is to reach a global agreement on changing the allocation of taxing rights on business profits in a way that expands the taxing rights of market jurisdictions.

As the OECD documents make clear, the Blueprint does not reflect agreement by the member jurisdictions of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) because there are political and technical issues that still need to be resolved. However, the cover statement of the Inclusive Framework refers to the Blueprint as a "solid basis for future agreement" and states that the member jurisdictions have agreed to keep working "to swiftly address the remaining issues with a view to bringing the process to a successful conclusion by mid-2021."

With the release of the Blueprint, the OECD also announced plans for consultations with stakeholders. The Inclusive Framework welcomes comments on all aspects of the Blueprint, with specific questions of particular interest laid

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out in a public consultation document. Interested parties are invited to submit written comments by 14 December 2020, and the OECD is planning to host virtual public consultation meetings in mid-January 2021.

The Blueprint indicates that the follow up work on Pillar One will focus on resolving the remaining political and technical issues, which include essential elements of Pillar One, such as issues around scope, quantum, the choice between mandatory and safe harbor implementation, and aspects of the new tax certainty procedures connected to Pillar One.

Detailed discussion

Background

In October 2015, the OECD released the Final Report on Action 1 (the Action 1 Final Report), *Addressing the Tax Challenges of the Digital Economy*, together with the final reports on the other 14 elements of the BEPS Action Plan. The Action 1 Final Report provides the OECD conclusions regarding the digital economy and recommended next steps to address the tax challenges presented by its evolution. The Action 1 Final Report states that special rules designed exclusively for the digital economy would prove unworkable, broadly stating that the digital economy cannot be ring-fenced because it "is increasingly becoming the economy itself," and summarizes key features of evolving digital business models that the OECD considers relevant for the overall BEPS analysis. In addition, the Action 1 Final Report considers broader direct and indirect tax challenges raised by the digital economy and evaluates options to address those challenges. However, the Action 1 Final Report does not recommend any of the options analyzed and leaves it up to individual countries to introduce any of them as additional safeguards against BEPS.

2018, the OECD released a document "Tax Challenges Arising from Digitalisation – Interim Report 2018" (the Interim Report) as a follow up to the Action 1 Final Report. The Interim Report sets out the Inclusive Framework jurisdictions' agreed direction of work on digitalization and the international tax rules through 2020. The Interim Report does not make any specific recommendations to countries, indicating instead that further work will need to be carried out to understand the various business models operated by enterprises offering digital goods and services, as well as digitalization more broadly. However, despite the technical complexity and the diverse positions, the Inclusive Framework jurisdictions agreed to undertake a coherent and concurrent review of the rules and achieve a consensus-based solution by 2020.[1]

In January 2019, the OECD released a Policy Note communicating that the renewed international discussions were going to focus on two central pillars: one pillar addressing the broader challenges of the digitalization of the economy and focusing on the allocation of taxing rights, and a second pillar addressing remaining BEPS concerns.[2] Following the Policy Note, in February 2019, the OECD released a Public Consultation Document[3] describing the two pillar proposals at a high level, received extensive comments from stakeholders, and held a public consultation in March 2019.[4]

Following the public consultation, in May 2019, the OECD released the "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy" (the Workplan).[5] The Workplan is divided into two pillars:

- Pillar One is described as addressing the allocation of taxing rights between jurisdictions and considers various proposals for new profit allocation and nexus rules.
- Pillar Two involves the development of a coordinated set of rules to address ongoing risks from structures that are viewed as allowing multinational enterprises to shift profit to jurisdictions where they are subject to no or very low taxation.

On 9 October 2019, the OECD released a public consultation document on an OECD Secretariat proposal for a "unified approach" under Pillar One and invited interested parties to submit comments.[6] The OECD held a consultation meeting in Paris on 21 and 22 November 2019 to give stakeholders an opportunity to discuss their comments with the Inclusive Framework jurisdictions.[7]

On 31 January 2020, the OECD released a Statement by the Inclusive Framework on the Two-Pillar Approach, according to which, members of the Inclusive Framework affirmed their commitment to reach an agreement on new international tax rules by the end of 2020.[8] Attached to the Statement were also more detailed documents, including an outline of the architecture and a revised workplan for Pillar One.

On 18 July 2020, the OECD released the OECD's Secretary-General report to G20 Finance Ministers and Central Bank Governors where it stated that the work on Pillar One had progressed and that a blueprint report on Pillar One would be developed for consideration by the Inclusive Framework at the October meeting (8-9 October 2020).[9]

On 12 October 2020, the OECD and the OECD/G20 Inclusive Framework on BEPS released a series of documents in connection with the BEPS 2.0 project, including a detailed report on the Blueprint on Pillar One (the Blueprint).[10]

The Pillar One Blueprint

The aim of Pillar One is to reach a global agreement on adapting the allocation of taxing rights on business profits in a way that expands the taxing rights of market jurisdictions.

In order to achieve this, Pillar One contains three elements:

(a) New taxing rights for market jurisdictions over a share of the (deemed) residual profits of a multinational enterprises group (MNE) or segment of such a group (Amount A)

(b) A fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction (Amount B)

(c) Processes to improve tax certainty through effective dispute prevention and resolution mechanisms

Eleven building blocks that are considered essential to the construction of Pillar One are described in the Blueprint:

On Amount A:

1. Scope
2. Nexus
3. Revenue sourcing
4. Tax base determination
5. Profit allocation
6. Elimination of double taxation

On Amount B:

7. Scope
8. Quantum

On Tax certainty:

9. Dispute prevention and resolution for Amount A
10. Dispute prevention and resolution beyond Amount A

On all three elements:

11. Implementation and administration

The cover statement of the Inclusive Framework, which is incorporated in the Blueprint, describes the Blueprint as providing "a solid foundation for a future agreement that would adhere to the concept of net taxation of income, avoid double taxation and be as simple and as administrable as possible." It further indicates that a new multilateral convention is to be developed as the best and most efficient way of implementing Pillar One. Looking ahead, the Blueprint references the need for the Inclusive Framework to focus on the remaining political and technical issues, including issues related to scope, quantum, the choice between mandatory and safe harbor implementation, the new tax certainty procedures with respect Amount A, and enhanced tax certainty procedures for issues beyond Amount A.

The Blueprint notes that political decisions are required on several issues, including:

- The scope of Amount A, where some member countries have advocated a phased approach for implementation with Pillar One applying to automated digital services first and to consumer-facing businesses later, and the United States has proposed implementation of Pillar One on a safe harbor basis.
- The amount of profit to be reallocated under Amount A.
- The extent of mandatory binding dispute resolution beyond Amount A.
- The scope and application of Amount B, including the potential for implementation through a pilot program to allow for evaluation of the intended simplification benefits in practice.

Amount A

Scope

Chapter 2 of the Blueprint includes detailed rules on scope. The new taxing rights under Amount A only apply to MNEs that fall within the defined scope. Regarding the scope of Amount A, the Blueprint distinguishes between two types of tests that should be met: the activity tests and the threshold tests. The activity tests are designed to capture those MNEs that can participate in a sustained and significant manner in the economic life of a market jurisdiction, without necessarily having a commensurate level of taxable presence in that market under existing nexus rules. This covers MNEs that fall in either or both of the following categories: automated digital services and consumer-facing businesses.

Automated digital services (ADS) are generally defined in the Blueprint as services that are both automated (i.e., the provision of the service to a particular user requires minimal human involvement) and digital (i.e., provided over the

Internet or an electronic network). In defining ADS in this manner, it is recognized that certain MNEs can generate revenue from the provision of ADS to a large number of customers (or users) remotely and to markets where the MNE has little or no infrastructure. The definition of ADS is comprised of positive and negative lists of ADS activities, as well as a general definition. If an activity is on the positive ADS list, it is an ADS business. The positive list includes online advertising services, sale or other alienation of user data, online search engines, social media platforms, online intermediation platforms, digital content services, online gaming, standardized online teaching services, and cloud computing services. If an activity is on the negative ADS list, it is not an ADS activity. The negative list includes customized professional services, customized online teaching services, online sales of goods and services other than ADS, revenue from the sale of a physical good irrespective of network connectivity, and services providing access to the Internet or other electronic networks. If an activity is not on either list, the general definition is applied. The general definition is included as a supplement to the two lists to account for the rapidly changing nature of digitalized business models.

Consumer-facing businesses (CFBs) are defined in the Blueprint as those businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, including those selling indirectly through intermediaries and by way of franchising or licensing. In this respect, the nature of the good or service should be such that it is designed primarily for sale to consumers. To be considered a CFB, the MNE should be: (i) the owner of the consumer product/service and holder of the rights to the connected intangible property (including franchisors and licensors); or (ii) the "retailer" or other contractual counterparty of the consumer. In the case of the pharmaceutical sector, the Blueprint provides two options that are being considered by the Inclusive Framework for what drugs are in scope – all drugs or all over-the-counter drugs. Specific guidance is provided in the Blueprint on how these principles should be applied for intermediaries, for dual use (intermediate) goods and services, and in relation to franchising and licensing arrangements. The following activities are specifically excluded from Amount A: certain natural resources; certain financial services; construction, sale and leasing of residential property; and international airline and shipping businesses.

For activities that may be both ADS and CFB, the ADS definition applies.

The threshold tests for Amount A are divided into (i) a global revenue test and (ii) a de minimis foreign in-scope revenue test. The global revenue test aims to exclude MNEs below a certain annual consolidated revenue threshold from Amount A. In the Blueprint, it is contemplated to apply the €750 million threshold that is used for country-by-country reporting purposes. The de minimis foreign in-scope revenue test is intended to exclude MNEs that have a small amount of foreign in-scope revenue, which would result in a low amount of total profits to be reallocated under Amount A. Under this test, the amount of total revenue from in-scope activities (i.e., from automated digital services or consumer-facing businesses) should be determined first. Subsequently, it should be assessed whether this revenue is related to "foreign" activities, which are those activities that occur outside an MNE's domestic or home market. This home market may be defined as where the group is headquartered or where the ultimate parent entity is tax resident. The Blueprint uses a threshold of €250 million in an example illustrating the de minimis foreign in-scope revenue test. The Blueprint indicates that further work will be performed to agree on the definitive thresholds, including the potential application of a phased approach regarding these threshold tests, which could entail a higher threshold that is applicable initially and is gradually reduced over several years.

The Blueprint states that scope is one of the key pending political issues. In order to deliver a solution in 2020 in accordance with the original G20 mandate, some members of the Inclusive Framework have advocated for a phased implementation with ADS coming first and CFB following later. As an alternative to an activities-based test for scope, the United States has proposed implementing the new taxing right on a "safe harbor" basis, which would enable an MNE to elect on a global basis to be subject to Pillar One, but many countries have expressed skepticism about such an approach.

Nexus

Chapter 3 provides the rules on nexus. The new nexus rules determine entitlement of a market jurisdiction to an allocation of Amount A only. They are not intended to alter the nexus for other tax purposes, customs duties or for any other non-tax area. The Blueprint sets different nexus rules for ADS and CFB. For ADS, nexus would be established by exceeding a market revenue threshold (of [€ X million] per year). The Blueprint indicates that because MNEs are able, through the provision of ADS, to actively participate in the economic life of market jurisdictions without a physical presence, a revenue threshold is the only test to establish nexus.

For CFB, the nexus standard under the Blueprint would be higher than for ADS and would require an additional indicator which would evidence a significant and sustained engagement in the market jurisdiction beyond mere sales. The "plus factor" described in the Blueprint is a subsidiary or permanent establishment (PE) that carries out activities in the market jurisdiction that are connected to in-scope sales. This plus factor would entail a physical presence test with relevant sales-related activities. If any entity in the group meets this test, this plus factor requirement would be met for the entire group and would create a "group-PE" for purposes of Amount A. Under the Blueprint, the intention is for this group-PE definition to be a self-standing provision, not connected to existing tax treaties or domestic legislation, although the starting point for designing this definition will be the PE definition included in the OECD and United Nations model tax conventions: a fixed place of business through which an in-scope CFB of the MNE is wholly or partly carried on. Other plus factors that are being considered by the Inclusive Framework are the possibility of treating revenues above a certain threshold as a plus factor, a test based on sustained presence of personnel in a market jurisdiction, and a test based on advertising and promotion expenditure.

Further work on the nexus requirements will relate to the decision whether to apply a temporal requirement to avoid the effects of isolated or one-off transactions; consideration of the use of a lower nexus standard for smaller developing countries and higher thresholds for large markets; and specifically for CFB, the details of the standalone group-PE definition as well the potential use of a higher revenue threshold and other tests as plus factors.

Revenue sourcing

Chapter 4 outlines detailed revenue sourcing rules, to determine the revenue that would be treated as deriving from a particular market jurisdiction. The rules would be relevant in applying the scope rules, the nexus rules and the Amount A formula.

The rules aim to balance the need for accuracy with the ability of in-scope MNEs to comply, without incurring disproportionate compliance costs. Sourcing principles differ between ADS and CFB – and these broad categories are further subdivided based on business model. Each type of activity has its own set of sourcing rules, supported by a range of specific indicators. The indicators are organized in a defined hierarchy. MNEs should generally use the indicator that is first in the hierarchy. If that indicator is unavailable or unreliable, they may use the next indicator under the hierarchy. Guidance is provided on when an indicator can be considered to be unavailable or unreliable.

Chapter 4 also provides guidelines on documentation requirements, including on the MNE's internal control framework – and specifies that the information retained should be at a systemic level (and not a record of all data points). In addition, it provides information on the review by tax administrations of revenue sourcing – including the possibility of relying on the tax certainty process described in Chapter 9. Finally, the Blueprint describes the further work to be done by the Inclusive Framework on revenue sourcing.

Tax base determinations

Chapter 5 outlines proposed guidance for determining the tax base, or the Amount A pool of profits to be allocated. The tax base is determined on the basis of groupwide, rather than separate entity, profits. MNEs are permitted to rely on the Generally Accepted Accounting Principles (GAAP) used by the Ultimate Parent Entity (UPE) in preparing consolidated financial accounts, provided this standard produces equivalent or comparable outcomes to International Financial Reporting Standards (IFRS). The selected measure of profit is Profit Before Tax (PBT) from the consolidated Profit and Loss statement, with a few adjustments such as adding back any income tax expense.

The Blueprint outlines a three-step framework for determining whether an MNE will be required to apply segmentation to its business to determine the tax base. This framework is intended to balance simplicity with accuracy and complexity. First, the MNE allocates revenue between ADS, CFB and out-of-scope activities. Second, if revenue is below a certain threshold, a groupwide analysis will be undertaken. Third, MNEs with higher revenue would then apply "segmentation hallmarks" to evaluate whether segmentation by business line or geography is required. Where the hallmarks are displayed, the MNE may rely on disclosed segmentation as a rebuttable presumption. Further work will be undertaken by the Inclusive Framework on a variety of segmentation issues, including revenue thresholds, allocation of indirect costs, treatment of inter-segment transactions, third party revenue requirements, and whether exemption from segmentation in certain cases is mandatory or optional.

To account for losses, the Amount A tax base rules will apply consistently at the level of the group or segment irrespective of whether the outcome is a profit or loss.

Any losses arising from a taxable period will be preserved and can be carried forward to subsequent years through an "earn-out" mechanism. This means that Amount A losses will be reported and administered through a single account for the relevant group or segment, separate from any existing domestic loss carryforward regime. Losses from one segment will not be available to offset losses in another segment. Further work will include evaluation of the time limit (if any) for pre-regime losses, the implication of possible unlimited carryforward of in-regime losses, the impact of business reorganizations, and whether losses should be available to offset "profit shortfalls" where the PBT falls below the specified threshold for deemed routine profit.

Profit allocation

Chapter 6 discusses the calculation of Amount A, the interaction between Amount A and profit allocation under the arm's-length principle (ALP). It also provides options to address – in conjunction with Chapter 7's discussion of elimination of double taxes - double counting of taxing rights that may arise in particular circumstances, such as decentralized business models and relatively autonomous domestic businesses. Chapter 6 begins with a simple formulaic exposition, and then provides a multitude of options in order to address a myriad of important policy and administrative considerations.

The formula to determine the quantum of Amount A

The chapter establishes at the outset that "Amount A will be delivered through a formula that is not based on the ALP." The Amount A formula is comprised of three distinct components:

- Step 1: A "profitability threshold" to isolate residual profits potentially subject to reallocation
- Step 2: A "reallocation percentage" that defines the share of residual profits (actual profits minus the profitability threshold), or allocable tax base, that is allocated to market jurisdictions
- Step 3: Use of an allocation key to allocate the allocable tax base among the eligible market jurisdictions

The Blueprint does not specifically define the critically important profitability threshold or reallocation percentage threshold (e.g., "10 percent profitability threshold and 20 percent reallocation percentage"). These will be the subject of further work by the Inclusive Framework.

The allocation key (step 3) defines the mechanism for allocating the Amount A profit to eligible market jurisdictions (that is, jurisdictions with Amount A nexus). The allocation is based on in-scope revenues and could be implemented through either a profit-based or profit margin approach. Under the profit-based approach, PBT would be multiplied by the ratio of locally sourced revenue to total revenue of the MNE, including revenue from ineligible market jurisdictions and *potentially* including out-of-scope revenue. Under the profit margin approach, the allocable tax base of PBT/Revenue would by multiplied by locally sourced in-scope revenue. Further work will be required to determine if the existing definitions of revenue provided by accounting standards could be used.

Potential differentiation mechanisms

While there is no consensus yet on fixed Amount A Step One and Step Two parameters (e.g., 20/10), the Blueprint explores potential expansion of the framework through "differentiation mechanisms." These are alternative specifications of the parameters to enhance reliability and/or better achieve the underlying objectives of Pillar 1. All of the differentiation proposals are options being considered by the Inclusive Framework countries; none has achieved consensus.

"Digital differentiation" increases the allocable tax base for higher degrees of digitalization, perhaps through industry-specific guidance, by lowering the profitability threshold or raising the reallocation percentage. The intent is to provide a higher allocable tax base for groups or segments providing primarily ADS. Alternatively, a "profit escalator" provides for Amount A progressivity based on overall (group wide or segment) profitability.

Additionally, "some member countries" also advocate additional measures, such that if an ADS or CFB business makes remote sales through digital means, that jurisdiction should receive an allocation of *routine* profits even if the MNE is below the profitability threshold. "Other member countries," on the other hand, take the view that there would be *no* case for reallocating both routine profits from distribution activities and residual profits.

"Jurisdictional differentiation" attempts to account for variations in profitability across regions by potentially weighting the Amount A formula to allocate more profits to more profitable markets. This would avoid or lessen the possibility that profits from more profitable market jurisdictions would be allocated to less profitable market

jurisdictions. While jurisdictional differentiation is inconsistent with the overall approach of calculating the profits allocable to a market jurisdiction on a group or segment basis, the Blueprint notes that other aspects of Amount A could mitigate this, such as the elimination of a double tax mechanism outlined in Chapter 7, and a "domestic business exception" described below.

The issue of double counting

Amount A is an overlay to the existing income tax system, and interaction with that system could lead to duplicative taxation. Specifically, if the existing system already allocates residual profits to market jurisdictions, such profits may be taxed twice through regular transfer pricing rules and again through Amount A. Accordingly, the Blueprint provides an option for a "marketing and distribution profits safe harbor." This defines a safe harbor return as a cap that adds a fixed return for in-country routine marketing and distribution activities to the Amount A calculation. This would be applied on a market-by-market basis, as follows:

- Where the existing market and distribution profit is lower than the fixed return, the MNE group will not be eligible for the safe harbor.
- Where the existing marketing and distribution profit exceeds the fixed return, but is below the safe harbor return, the Amount A allocated to that jurisdiction would be reduced to the difference between the safe harbor return and the profit already allocated to the local presence. The Blueprint also notes that this entity may still be identified as a paying entity under the Chapter 7 guidance.
- Where the existing marketing and distribution profit exceeds the safe harbor return, no Amount A would be allocated to the jurisdiction.

The safe harbor attempts to address situations to which the Pillar One rules were not intended to apply. This would be particularly relevant for decentralized businesses that realize residual profits in a large number of entities and jurisdictions. The title of the safe harbor suggests that this issue of existing in market residual profits is only relevant for consumer facing businesses. However, it is not clear why the same would not apply to ADS business models where in market residual profits are realized and taxed.

The Blueprint does not address whether the "fixed return for marketing and distribution" is intended to be the same as or in some way related to Amount B but notes that this is another parameter for the Inclusive Framework countries to define.

As an alternative or addition to the marketing and distribution safe harbor, the Blueprint discusses the possibility of a "domestic business exemption" to exclude from the scope of Amount A large, domestically focused business with minimal foreign income. This would be warranted because profits deriving from the sale of goods or services that are developed, manufactured, and sold in a single jurisdiction are outside of the policy objectives of Pillar One. The Blueprint notes that this might be easier to describe than administer, as it may be difficult to isolate and segment standalone domestic business from other group entities. Finally, it is indicated that the double counting issue could also be resolved through step 3 of the process of elimination of double taxation (See Chapter 7).

Next Steps

The Inclusive Framework will continue work on the undefined parameters, such as the profitability threshold and reallocation percentages, and on determining which options and variations to adopt.

Elimination of double tax

Chapter 7 discusses the elimination of double taxation. Amount A will apply as an overlay to the existing profit allocation rules. The interaction between the existing profit allocation rules and the new taxing right (Amount A) needs to be reconciled in order to prevent double taxation. The mechanism to allow this reconciliation is based on two components: 1) Identifying the paying entities; and 2) methods to eliminate double taxation.

Component 1: Identifying the paying entities

To identify the entity or entities paying the Amount A tax liability (i.e., the "paying entities"), Pillar One contemplates four steps. Step one is a qualitative "activities test" to identify entities that make material and sustained contributions to the residual profits of the MNE. It includes a general principle describing the type of activities, supplemented by a list of factors to support its application. Step two is a quantitative "profitability test" to ensure paying entities have the capacity to pay Amount A. Under step three, a "market connection priority test" is applied that would require that the Amount A taxing right of a market jurisdiction would first be allocated to potential paying entities that have a connection with this market jurisdiction. Finally, under step four, where the paying entities which have a connection with the market jurisdiction do not have sufficient profits to pay the full Amount A tax liability, any

outstanding tax liability could be apportioned between other potential paying entities (not connected to the market) on a pro-rata basis.

Other alternative "back-stop" bases are also being considered by the Inclusive Framework. In addition, consideration is to be given to whether and how this process could be simplified by eliminating the first step and/or third step and applying a more quantitative and formulaic approach. Moreover, discussions are ongoing on the implications of transfer pricing adjustments and carried-forward losses.

Component 2: Methods to eliminate double taxation

After identifying the paying entities, the application of a method to eliminate double taxation ensures that a paying entity is not subject to double taxation on the same profits in different jurisdictions, once based on the existing transfer pricing rules and once based on the new taxing right (Amount A). The suggestion is for the jurisdiction where the paying entity is resident to relieve double taxation using the exemption or credit method.

Application of the marketing and distribution profits safe harbor

As indicated in Chapter 6, a marketing and distribution safe harbor is available which limits or nullifies Amount A allocation to market jurisdictions where the marketing and distribution activities are already allocated residual profits under the existing profit allocation rules. In Chapter 7, it is indicated that this would only apply as far as these marketing and distribution profits can be considered to be arm's length. Moreover, it is also indicated that the applicability of the safe harbor does not exclude the entities involved from being potential paying entities for the remainder of Amount A allocated to other market jurisdictions.

Next steps

For Component 1, the Inclusive Framework will need to make a final decision on the design of the tests to identify the paying entities. For Component 2, further work will be required to provide guidance to jurisdictions in selecting and applying either the exemption or the credit method to relieve double taxation.

Amount B

Chapter 8 discusses Amount B, which is intended to standardize the remuneration of related party distributors that perform "baseline marketing and distribution activities" in a manner that is aligned with the arm's-length principle. These rules are intended to simplify the administration of transfer pricing rules and reduce compliance costs, while also enhancing tax certainty and reducing controversy. Amount B will apply to entities or PEs with existing nexus, and as such is not related to the new nexus rules of Amount A. Importantly, the scope limitations of Amount A relating to the activity tests and threshold tests are not applicable to Amount B.

The controlled transactions in scope of Amount B could consist of (i) the purchase of products from related parties for resale to unrelated customers predominantly, and the associate performance of baseline distribution activities; and (ii) the performance of baseline marketing and distribution activities in the state of residence, transacting or dealing with a foreign associated enterprise.

Amount B would apply to distribution activities that according to the accurate delineation of the transaction would be characterized as a routine distributor. Marketing and distribution activities as in- or out-of-scope activities will be identified by reference to defined "positive lists" and "negative lists" of qualitative factors. These lists include examples of functions, assets and risks that would be (positive list) and would not be (negative list) expected of a distribution entity with baseline activities. Certain quantitative factors would also be used to further support the identification of in-scope activities. The current intention is for Amount B to apply to a relatively narrow scope of entities that would generally be characterized as a routine distributor in relation to a controlled transaction, excluding commissionaires and sales agents. However, some Inclusive Framework members want to explore the feasibility of broadening the scope.

The quantum of Amount B and thereby the remuneration for the baseline marketing and distribution activities will be determined using the transactional net margin method. A rebuttable presumption may be introduced for cases where evidence is provided that another transfer pricing method is the most appropriate method to use. With respect to the appropriate profit level indicator, a sales-based remuneration (return on sales) is considered. These would be determined through a reference benchmark set, in which differentiated returns may apply for regions and industries. The Blueprint states that given the envisaged narrow scope of the baseline activities, no attempt will be made to account for functional intensity in the benchmark sets.

Amount B would be implemented through domestic law or regulations. The Blueprint indicates that existing treaties can resolve disputes over Amount B. Where there is no treaty in place, a new treaty-based dispute resolution mechanism may be required.

Further work by the Inclusive Framework will include focusing on the scope of Amount B, finalizing the determination of the profit level indicator, determining the regions and industries to which differentiated returns should apply, and considering the merits and objectives of a potential pilot program for Amount B.

Tax certainty

In Chapter 9, the Blueprint proposes two sets of tax certainty rules – dispute prevention and resolution for Amount A and dispute prevention and resolution for amounts beyond Amount A.

Regarding Amount A, the Blueprint proposes a mandatory binding dispute prevention process that aims to address in advance potential issues regarding Amount A – such as the correct delineation of business lines and calculation of its profits, the existence of nexus, or the identification of paying entities. The process would be based on an MNE's self-assessment that would be reviewed by a representative review panel in first instance and, if no agreement can be reached at that stage, by a determination panel in second instance. The agreement reached in this process would be binding on all relevant tax administrations and on the MNE.

The Blueprint contains a detailed draft outline of the early certainty approach including various elements and stages:

- The process would start with a self-assessment return by the MNE, which would be filed with a lead tax administration.
- After validation, the lead tax administration would exchange it with the relevant other tax administrations.
- An MNE could make a request to the lead tax administration for certainty on whether it is in scope of Amount A and whether the determination and allocation of Amount A is correct.
- The lead tax administration can conduct an optional review with the aim to provide a recommendation whether it is necessary to establish a review panel.
- If a review panel is established, it would ideally include six to eight tax administrations, depending on the MNE's footprint.
- Tax administrations are expected to endeavor to reach an agreement within the review panel but are not required to do so.
- Assuming that no affected tax administration objects, the self-assessment agreed with the review panel is binding on the MNE and all Inclusive Framework members.
- If there are objections that cannot be resolved, the matter would be referred to a determination panel.
- The determination panel would consider the review panel's analysis and the alternative responses presented on the contentious issues. It will come up with a decision using a "last best offer" approach (if possible, by consensus, but simple majority and other options are also allowed).
- If the determination panel confirms an approach already agreed by the MNE, the Amount A assessment becomes binding on the MNE and all Inclusive Framework tax administrations.
- If the MNE does not accept the decision of the review panel or of the determination panel, it can withdraw the request for certainty. In that case, the MNE may then rely on domestic procedures in each jurisdiction.

The Blueprint also contemplates additional procedures for certainty to determine: (i) whether an MNE falls within the scope of Amount A; (ii) whether a jurisdiction is a market jurisdiction – to be started upon the initiative of tax administrations; (iii) whether the self-assessment of an MNE is correct when there's no request for tax certainty – upon the initiative of tax administrations; or (iv) whether the MNE can seek dispute resolution when it did not submit a request for early certainty.

An enhanced dispute resolution process is suggested for cases where an MNE does not opt into the certainty process, however, it is expected that most MNEs in scope would make use of the prevention mechanism.

The rules for the prevention and the resolution regarding Amount A would be included in the multilateral instrument that would introduce the rules on taxation of Amount A. See Chapter 10.

The tax certainty approach beyond amount A includes a number of steps, including dispute prevention, use of the existing mutual agreement procedure (MAP), as well as a new mandatory binding dispute resolution mechanism. For developing countries, elective binding dispute resolution is contemplated. In designing these tax certainty approaches,

lessons learned from the existing tax certainty initiatives are taken into account, including strengthening the BEPS Action 14 minimum standard based on the work of the Forum on Tax Administration MAP Forum and Working Party 1.

Finally, the Inclusive Framework is exploring a mandatory binding dispute resolution for MAP cases that remain unresolved after an agreed period. The Inclusive Framework would agree on the defined period after which the dispute resolution mechanism would be triggered and the mutual agreement would be submitted to a panel of experts (a determination panel) who would reach a decision. Ongoing technical work is addressing the potential structure and authority of the determination panel, as well as its potential interaction with existing mandatory binding dispute resolution mechanisms.

Implementation and administration

Chapter 10 addresses implementation issues. The Blueprint indicates that the implementation framework for Pillar One is yet to be developed. This will require action across three different aspects: domestic law, public international law and guidance to supplement these two elements.

The translation into domestic law is aimed at achieving: (i) a domestic taxing right consistent with the design of Amount A; (ii) relief of double taxation; (iii) incorporation of procedures to administer the new rules; and (iv) processes to improve dispute resolution. As existing tax treaties prevent the application of Amount A, changes to public international law are also needed, likely through the development of a multilateral convention. Such a multilateral convention will not be designed to change existing bilateral treaties but will co-exist beside, and supersede only certain provisions of, existing treaties. Changing bilateral treaties alone would not be sufficient, as multilateral mechanisms are necessary to implement the multilateral dispute prevention and resolution mechanisms foreseen by Pillar One. Thus, the multilateral convention would need to contain the following elements: (i) removal of treaty barriers to determine a new Amount A tax; (ii) elimination of double taxation; (iii) procedure for tax certainty regarding amount A; and (iv) other tax-certainty processes beyond Amount A. Finally, in addition to the domestic and the public international law changes, guidance will be developed to secure coordinated implementation.

On the key question of removal of unilateral measures, it is expected that any consensus agreement will require a commitment for such removal. However, no implementation guidance on this has been developed yet. The Blueprint states that work will be required on identifying what unilateral measures need to be withdrawn and on a transitional framework for doing so.

Next steps

The public consultation on the Pillar One Blueprint will be open for stakeholder input until 14 December 2020 and all written comments received will be made publicly available. Public consultation meetings on the Blueprints will be held in January 2021. Looking ahead, the Inclusive Framework has agreed to work quickly to address remaining issues with respect to both Pillars with a view to reaching a successful conclusion by mid-2021.

Implications

The proposals under Pillar One represent a substantial change to the tax architecture and go well beyond digital businesses or digital business models. These proposals could lead to significant changes to the overall international tax rules under which businesses operate. It is important for businesses to follow these developments closely in the coming months and to consider engaging with the OECD and policymakers at both national and multilateral levels on the business implications of these proposals. Businesses also should evaluate the potential impact of these proposed changes.

If no agreement can be reached by mid-2021, it is expected that many countries will introduce digital services taxes. Moreover, countries could introduce other elements of the Pillar One architecture through their domestic legislation, such as for example a variation of Amount B. If there is no coordinated global agreement, this would be expected to lead to a rise in double taxation and controversy.

The Blueprint and the other developments with respect to the BEPS 2.0 project will be discussed on the upcoming EY Global Thought Center webcast Taxation of the digitalized economy: What's next on 28 October 2020.

Endnotes

1. See EY Global Tax Alert, *The OECD's interim report on tax challenges arising from digitalisation: An overview*, dated 21 March 2018.
2. See EY Global Tax Alert, *OECD's new insights describe growing support on comprehensive changes to international tax policy, beyond digital*, dated 29 January 2019.
3. See EY Global Tax Alert, *OECD opens public consultation on addressing tax challenges arising from digitalization of the economy: time-sensitive issue impacting all multinational enterprises*, dated 14 February 2019.
4. See EY Global Tax Alert, *OECD hosts public consultation on document proposing significant changes to the international tax system*, dated 18 March 2019.
5. See EY Global Tax Alert, *OECD workplan envisions global agreement on new rules for taxing multinational enterprises*, dated 3 June 2019.
6. See EY Global Tax Alert, *The OECD takes next step on BEPS 2.0 – Proposal for a "unified approach" for additional market country tax*, dated 10 October 2019.
7. Ibid
8. See EY Global Tax Alert, *OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two*, dated 7 February 2020.
9. See EY Global Tax Alert, *OECD issues report to G20 finance ministers and Central Bank governors and hosts webcast to provide update on tax work*, dated 29 July 2020.
10. See EY Global Tax Alert, *OECD's Inclusive Framework releases BEPS 2.0 documents and agrees to continue work with target of conclusion by mid-2021*, dated 13 October 2020.

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EYG no. 006985-20Gbl

1508-1600216 NY
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