

## OECD and country officials discuss OECD workplan for new rules for taxing multinational businesses and ongoing projects

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### Executive summary

The Organisation for Economic Co-operation and Development (OECD) held its annual tax conference in Washington, DC, on 3-4 June 2019. This year a significant part of the discussion at the conference focused on the Workplan released by the OECD on 31 May 2019 laying out its plans for reaching a global agreement on new international tax rules for taxing multinational businesses.<sup>1</sup> In addition, there were sessions on the OECD's other ongoing work on transfer pricing, tax treaties, cooperative compliance, and mutual agreement procedure (MAP).

Several senior members of the OECD Secretariat participated in the conference, along with tax officials from several OECD and G20 countries who are responsible for work with the OECD, including officials from Canada, France, Germany, the Netherlands, the United Kingdom (UK), and the United States (US).

### Detailed discussion

The OECD's annual tax conference in Washington, DC on 3-4 June 2019 provided an opportunity for dialogue with members of the OECD Secretariat and OECD and G20 country tax officials about the just-released Workplan for reaching agreement on new international tax rules for multinational businesses.

The discussion covered the two areas of work on addressing the tax challenges of the digitalization of the economy contemplated in the Workplan:

- Pillar 1 on revisions to the existing profit allocation and nexus rules
- Pillar 2 on development of new minimum tax rules

The panels for the discussion sessions included members of the OECD Secretariat, country tax officials who are involved in the work of the OECD, and business community representatives.

In the opening remarks, the tone was set for the rest of the conference. Representatives of Business at OECD (BIAC) stressed that global growth should be front and center when it comes to designing new tax policy. They noted that in the current climate, innovation seems to be demonized, instead of being recognized for its contribution to fostering growth. They encouraged the OECD to adopt this positive perspective regarding technological developments in conducting the work contemplated in the new Workplan.

Martin Kreienbaum, Chair of the OECD's Committee on Fiscal Affairs and Director General of International Taxation at the Federal Ministry of Finance in Germany, emphasized the need for stability in the tax system. He indicated that this can only be achieved if there is predictability and certainty, but expressed the view that the international tax system currently is lacking these characteristics due to the continuing debate around "fair taxation." Kreienbaum noted there is no unambiguous answer to what fair taxation is. Different countries have different perspectives on what they think their fair share is, which is a major source of pressure on the existing international tax system. In Kreienbaum's view, the Inclusive Framework on BEPS, which currently consists of 129 jurisdictions, is best positioned to answer this question on a consensus basis. He sees this as the aim of the new Workplan.

## The Road to 2020: Tax Challenges of Digitalization

This session provided an overview of the Workplan for the OECD's work on addressing the tax challenges of digitalization of the economy. The panel included Pascal Saint-Amans, Director of the Center of Tax Policy and Administration at the OECD; Brian Jenn, Deputy International Tax Counsel at the US Department of the Treasury; and Gaël Perraud, Director of International Taxation and European Affairs at the French Ministry of Economy and Finance. Jenn and Perraud are co-chairs of the OECD task force on the digital economy.

Saint-Amans began by introducing the Workplan. He indicated that predictability and certainty are under pressure due to the dissatisfaction of jurisdictions with the current allocation of taxing rights and the resulting unilateral actions. The challenge will be the ability to get consensus from 129 countries and at the same time provide stability to taxpayers and administrations.

When reflecting on the reasons why this new project is essential for the stability of the international tax system, even though the Base Erosion and Profit Shifting (BEPS) project was just concluded in 2015, Saint-Amans indicated that the BEPS project accomplished many goals, but that some OECD members felt that it did not go far enough, in particular with respect to Action 1 on the digital economy and Actions 8-10 on transfer pricing. He expressed the view that the US tax reform provided an opening for taking a less conservative approach to addressing these issues, which led to the Inclusive Framework on BEPS agreeing at the end of 2018 to work, on a consensus basis, on a long-term solution in these areas.

Following these reflections, Saint-Amans described what he sees as the commonalities in what countries want to achieve with Pillar 1:

- More profits to be attributed to market jurisdictions
- Movement away from the arm's-length principle by looking at group profits and moving to some form of residual profit splits of those profits
- Simplification of the transfer pricing rules
- Design of a new nexus concept that is not dependent on a physical presence

Regarding the OECD's next steps, Saint-Amans indicated it is essential for countries to decide on a unified conceptual approach as soon as possible and by the end of this year. Simplification may help to bring these countries together. He also emphasized that the new allocation rules should create a level playing field and should not harm small open economies or developing countries.

Perraud reflected on the dynamics behind the three different profit allocation options that are being considered in the work on Pillar 1, explaining how they are linked to three key dynamics that have been evolving over the past decades and that are affecting the current international tax system. First, innovation and the challenges posed by the digitalization of the economy have led in many jurisdictions to dissatisfaction about the profits allocable to them, because of concern that

activities can take place in a country without a business having a taxable presence. This explains the first profit allocation proposal, the user participation proposal. Perraud noted that this proposal is sometimes referred to as the “UK proposal,” but said that it would be better to refer to it as the “European proposal” because the discussion of the introduction of a digital services tax in Europe has shown that many countries in the European Union support a change in the division of taxing rights to take digitalization into account.

As a second important dynamic, Perraud said it should be recognized that for several years there has been a strong push for more taxation in market countries. This is exacerbated by the digitalization of the economy, but is broader in scope as illustrated by the many disputes and open MAP cases on this issue involving traditional businesses. Ensuring that these disputes are prevented, and certainty is provided, is one of the drivers behind the second profit allocation proposal, the market intangibles proposal.

Finally, Perraud stated that it also should be recognized that emerging and developing economies have in the past stressed that there should be more allocation of taxing rights to source countries and have expressed concern that the OECD transfer pricing rules are too complex for them to administer. This has led to disputes and double taxation. These perspectives of emerging and developing economies are reflected in the third profit allocation proposal, the significant economic presence proposal.

In Perraud’s view, if consensus can be achieved in the OECD project, the uncertainty and double taxation that result from the above dynamics would be addressed, reinstating stability and predictability in the international tax system.

Like Saint-Amans, Perraud emphasized the need for convergence of the profit allocation proposals into one proposal during 2019. Both the G7 meeting in July and, more importantly, the G20 meeting in the fall are going to be key meetings in achieving this convergence.

From a US perspective, Jenn started by agreeing with the previous speakers’ comments on what had led to the three alternative profit allocation options reflected in the Workplan. He noted that the work under Pillar 1 on revising profit allocation and nexus rules seems to be the only way to restore stability to the tax system and avoid unilateral measures. He further noted that there is an unraveling of the consensus around the arm’s-length standard and that the formulary approaches being considered are necessary to increase certainty and stability. He stressed that any elements

of new profit allocation rules that do not rely on formulary approaches that are unambiguous must have robust dispute resolution mechanisms. Jenn noted that there may be carve-outs from the new rules in appropriate cases, and he expressed the view that the new rules should provide for a greater return to taxable presence and functions conducted in country than to remote activity. On Pillar 2 on new minimum tax rules, Jenn expressed the view that the primary focus will be on an income inclusion rule, while the undertaxed payment approach is likely to be a secondary rule used as a deterrent for countries that do not implement an income inclusion rule. He indicated that the minimum tax rules likely will be structured in a form similar to the BEPS hybrid mismatch rule with the addition of an effective tax rate test.

The business representatives on the panel welcomed the commitment to conducting an economic analysis and impact assessment that is reflected in the Workplan. The need for having a clear perspective on what has already been achieved through BEPS also was emphasized. Moreover, the business representatives called on the OECD to lean harder on jurisdictions taking unilateral actions. In addition, they stressed that experience shows that any type of residual profit split method is extremely complex to use and therefore should not be viewed as a potential step to simplification.

In response to a question about the OECD process for reaching agreement, Saint-Amans noted that for Pillar 1 to succeed, full consensus and implementation of the agreed profit allocation and nexus rules will be needed, but that Pillar 2 success will require only that a core group of countries implements the agreed minimum tax rules.

## **Tax Challenges of Digitalization: Profit Allocation and Nexus (Pillar 1)**

This session focused on the execution of the Workplan with respect to Pillar 1 on new profit allocation and nexus rules. The panel included Richard Collier, who recently joined the OECD Secretariat as Senior Tax Advisor; Chip Harter, Deputy Assistant Secretary (International Tax Affairs) at the US Department of the Treasury; and Michael Graetz, Professor of Tax Law at Columbia Law School.

Chip Harter stressed that in executing the Workplan the effort must focus on:

- ▶ Simplicity and administrability, in particular in light of the resource constraints of developing countries
- ▶ “Above-normal” profits and the use of administrative safe harbors for “routine” functional returns

- The essence of the bargain with the market jurisdictions that in exchange for additional taxing jurisdictions they must ensure more certain tax outcomes

Harter further noted that:

- The approach to re-allocate “above normal” profits in many instances may not achieve a significantly different result from current transfer pricing results. The focus should be on situations involving valuable intangibles that drive above normal returns where current transfer pricing and tax planning are able to relocate them away from markets.
- In specific businesses that have significant supra-normal returns, allocation to market jurisdictions can be based on formulaic methods using available data (e.g., country-by-country reporting data) or some incremental percentage could be negotiated based on an additional return on sales. This could be a significant re-allocation in some cases, but in cases of businesses with low margins, it could be little or nothing.

Harter reiterated that the challenges faced by the international tax system are broader than a focus on social media/digital companies and he emphasized that proposed changes need to be broad based. He also stressed the need for consensus to reinstate the stability of the international tax system.

The business representatives on the panel emphasized the need for business groups to actively engage and assess the impact of the proposals on their specific industries. They also stressed the need to rely on the work already done on the arm’s-length standard in the BEPS project, and the importance of continuing to work within that framework rather than developing an entirely new system of profit allocation. Implementation of mutually agreed and stable formulaic apportionment methods could prove elusive and could create the risk of unilateral actions, which was one of the problems the OECD set out to solve through this project.

Graetz noted that the Workplan represents a highly political process borne in an environment where big business is being demonized, which creates significant risk. In addition, Graetz stressed the difficulties in using formulaic approaches. He distinguished between a top-down approach (starting from the group-wide profits) and a bottom-up approach (starting from allocating routine remunerations and adding a “top up” for excess profits). He noted that experience has shown that agreeing on the tax base (group profits) to be divided under a top-down approach is extremely complicated. In his view, agreement under a top-down approach would likely only be

possible if the profit for financial reporting purposes were used as the starting point. He also stressed the difficulty in segregating marketing intangibles from other types of intangibles. Therefore, his conclusion was that a bottom-up approach would be less complex and thus less risky to implement.

## **Tax Challenges of Digitalization: Profit Allocation and Nexus (Pillar 1 continued)**

This session focused on key design considerations and administrative issues with respect to new profit allocation and nexus rules. The panel included Richard Collier of the OECD Secretariat; Gaël Perraud of the French Ministry of Economy and Finance; and Harry Roodbeen, Director of International Tax and Consumer Tax at the Netherlands Ministry of Finance.

Perraud discussed the three different approaches for applying the new profit allocation rules that are reflected in the Workplan: a “modified residual profit split approach (MRPS),” a “fractional apportionment approach”, and “distribution-based approaches.”<sup>2</sup> He noted that a similarity between the MRPS and the fractional apportionment approaches is that they both take a top-down approach by determining some aggregate measure of profits and then allocating those profits among jurisdictions. A key distinction between the two approaches, on the other hand, is that the former splits only non-routine profits while the latter splits overall profits. The distribution-based approach differs from the other two in that it is a bottom-up that starts, for example, from the financials associated with the market jurisdiction and builds up to the measure of the new market jurisdiction taxing right.

Perraud discussed some of the issues with which the OECD must grapple, such as:

- Should the proposal only apply to large business?
- Should there be other carve-outs and safe harbors?
- Should there be segmentation by business lines, and if so what would those business lines be?
- How should losses be taken into account?
- What measures would ensure elimination of double taxation?

Perraud also stressed that simplification should be a means to a goal, and not a goal in itself. In his opinion, striking the right balance between accuracy and simplicity would be one of the most important and challenging tasks.

A business representative noted that it would be important to clearly identify any tax treaty or domestic law changes that may be needed, as it may not be possible in all countries to get legislation enacted.

Following the general introduction, a more detailed discussion focused on group profits, a business-line approach, losses, identification of market countries, withholding tax as a collection mechanism and the distinction between routine and residual profits.

On group profits, Roodbeen said relating profit allocation to group profits is a necessary starting point, even though it makes the solution more complicated. Perraud added that he did not see any problems in creating a taxable presence without nexus, as that is already working in practice for value added taxes.

On business-line segmentation, Perraud noted that decisions on this issue fall into the category of finding a balance between accuracy and simplicity. Roodbeen and Perraud agreed that the standard should be auditability and expressed some optimism that business-line segmentation could be achievable in practice.

With respect to losses, Roodbeen and Perraud acknowledged the challenges, especially in the event of segmented business lines. Roodbeen expressed a preference for keeping losses within the segmented business rather than mixing them. Perraud said that it is important that if profits are allocated, then losses should be allocated too, which will require a determination of how best to do such allocation.

The panelists agreed that there would be important challenges in identifying market countries to which more profits should be allocated. A business panelist noted the difficulty in distinguishing between production and marketing intangibles, noting that good marketing efforts can only lead to a customer trying a product, but that customer loyalty to a product is dependent on its quality. Roodbeen and Perraud shared the view that the most difficult issue to resolve is third-party sellers.

On the topic of the role of withholding taxes, Perraud stated that, because the objective is taxing profits, taxing gross revenues is not the best solution, except perhaps on a short-term and temporary basis. Roodbeen agreed that he did not think a withholding tax approach would work, primarily because it would be the consumers who would have to withhold.

In response to a question on the feasibility of taxing residual profits, a business panelist noted that the traditional residual profit split is an extremely complex method to apply in practice. Therefore, any assumption that such a method would lead to simplification likely would be wrong. The other business panelists had more confidence in the ability to segregate routine and residual profits, but saw as the most difficult issue the allocation of the residual profits.

## **Tax Challenges of Digitalization: remaining BEPS Challenges (Pillar 2)**

This session focused on the work on Pillar 2 on development of new minimum tax rules to address what is perceived as the continued risk of profit shifting to entities subject to no or very low taxation. The panel included Achim Pross, Head of the International Cooperation and Tax Administration Division with the OECD Secretariat; Martin Kreienbaum of the German Ministry of Finance; and Chip Harter of the US Treasury Department.

Pross described the Pillar 2 proposal as involving two sets of rules. Income inclusion rules would allow the parent company country to apply a “top-up” tax to income of subsidiaries or branches that is subject to less than the agreed minimum rate of tax. The second set of rules would allow the country from which a payment is made to deny a deduction (or to deny treaty benefits) for such payment if the related-party recipient is subject to less than the agreed minimum rate of tax. He indicated that the two sets of rules would need to be coordinated.

The panel first discussed the intended objectives of the proposal for minimum tax rules. Kreienbaum noted that while these rules were a German proposal, lots of other countries have expressed political support for the concept. He expressed the view that such rules are needed to solve the core problem of base erosion and profit shifting. He further indicated that the two pillars reinforce each other. In addition, he stated that the proposal is not intended as an anti-abuse measure but rather reflects the view that there is a point at which the benefit of tax competition is outweighed by the harm. Kreienbaum further contended that the proposal does not treat a country’s low tax rates in a negative way, but merely would allow other countries to react to such low taxation. Harter offered perspectives on the US experience with similar rules included in the US tax reform. He expressed the view that minimum tax rules serve to reduce incentives for earning income offshore rather than onshore.



The business representatives expressed concern that it is premature to be considering additional rules to address profit shifting when the implementation of the measures recommended in the BEPS project is still ongoing; more time is needed for the BEPS changes to be fully implemented before the need for any further action can be evaluated. They also noted that the proposals were a major departure for the OECD, which historically has taken the position that low taxation alone cannot be considered a harmful tax practice and has left the determination of its tax rate to each country itself.

The panel then discussed the technical challenges associated with development of minimum tax rules. Harter noted the complexity of the technical issues that US Treasury is addressing in regulations with respect to the new US rules. He commented on the need for common rules for measuring the tax base to determine the effective tax rate and compare it to the agreed minimum tax rate. One suggestion was that income determined for financial accounting purposes be used, but the business representatives expressed concerns about the distortive effects that this could have, particularly as there can be wide variations in the degree of disparity between tax and accounting measures of income.

Harter advocated an averaging approach for determining effective tax rate, maintaining that a per country approach that does not allow income to be blended would lead to harsh results. Kreienbaum however expressed skepticism about the appropriateness of any approach that allowed blending of tax rates. Kreienbaum also was skeptical about the potential for any carve outs from the proposed minimum tax rules.

Kreienbaum, Pross, and Harter all agreed that a fixed minimum tax rate would be much more likely as an outcome under Pillar 2 than a minimum rate that is dependent on the tax rate of the particular country that is applying the minimum tax rules. The latter would be too complex to implement. When asked about the level of the rate, Harter jokingly placed his bet on a tax rate that would be “between the Hungarian and Irish tax rates.”

The business representatives expressed the view that the complexity of the technical issues and the difficulty in achieving the coordination that would be needed to prevent double taxation were additional reasons that the work on Pillar 2 should proceed cautiously and not under the aggressive timeline currently contemplated in the Workplan.

## Tax Treaties and MLI

This session focused on the latest developments with respect to tax treaties and the BEPS multilateral instrument (the MLI). The panel included Sophie Chatel, Head of the Tax Treaty Unit with the OECD Secretariat, and Mike Williams, Director of Business and International Tax at HM Treasury in the UK.

Chatel stated that the MLI has been a success story, with 88 signatories, 25 ratifications to date, and a number of jurisdictions working toward ratification in the near future. She expressed the view that the MLI has largely met its objective of implementing the BEPS minimum standards and has had a very positive impact in terms of introducing the potential for arbitration between jurisdictions. In this regard, 29 countries opted for the arbitration procedure in adopting the MLI.

Chatel further noted that tax treaties, and in particular the MLI, are relevant to the new Workplan. Changes to tax treaties will be necessary to effectively implement the Workplan outcomes under both pillars. Specifically, it is envisaged that any proposal under Pillar 1 that provides for an allocation of taxing rights over a portion of a nonresident enterprise's business profits in the absence of physical presence and computed other than in accordance with the arm's-length principle would require changes to existing treaties. Furthermore, Pillar 2 contemplates the design of a switch-over rule with respect to otherwise exempt income and possible modifications to the scope and operation of certain treaty benefits to facilitate a subject to tax rule.

Williams stated the importance of applying learning from the MLI experience to improve the process for future projects, specifically the Workplan proposals.

He expressed the view that the MLI has been a groundbreaking mechanism that has allowed for the modification of a large number of bilateral tax treaties in a quick and simplified manner, and ensured that all jurisdictions are on equal footing in respect of implementing changes to their respective tax treaty networks. However, some complexity remains in the MLI process because of the different options that the jurisdictions can choose among. While this flexibility has been viewed positively it has created complexity. In addition, there has been some concern expressed about the large scope and short time frame for jurisdictions to negotiate and ratify the MLI.

The general view of the panelists was that the level of flexibility in the MLI may not work if such an instrument is to be used to implement the Workplan treaty-related changes. The agreement used for the Workplan would need to be a “true” multilateral agreement, and not an instrument that simply allows modification of bilateral treaties. This is because the Workplan will not merely impact bilateral relationships, but will affect the allocation of group-wide profits across multiple jurisdictions. This will require a multilateral approach. However, the panelists anticipated that there would be difficulties in advancing a form of agreement with this kind of multilateral implications.

It is likely that an instrument with respect to the Workplan would need to include a new nexus provision and not merely an amendment to the existing permanent establishment provision in bilateral treaties. This will involve challenging technical issues, including determining which countries will provide relief from double taxation and how that relief will be provided and developing new non-discrimination and dispute resolution provisions that can work multilaterally.

## Improving Tax Certainty (Part I) – ICAP Cooperative Compliance

This session focused on developments on Advance Pricing Arrangements (APAs) and the OECD’s International Compliance Assurance Program (ICAP). The panel included Achim Pross of the OECD Secretariat; Alexandra MacLean, Director General of the International and Large Business Directorate at the Canada Revenue Agency; and Doug O’Donnell, Commissioner of the Large Business and International Division at the US Internal Revenue Service.

In his introduction, Pross set the tone by saying it is time the “A” is put back into APAs, noting that the time needed to conclude APAs means that there is not much “advance” about them.

MacLean and O’Donnell both reflected on their country’s respective APA programs. They both noted that on average an APA takes about four years to conclude and that the APA programs are moving toward bilateral and multilateral APAs, while unilateral APAs are becoming less common. MacLean described the Canadian plan to hold a consultation to solicit thoughts on improvements of the program. In addition, there is interest in Canada in incorporating the lessons learned from the ICAP program. Finally, MacLean recognized that there is a need to speed up the process. O’Donnell added that Canada and the US may also be undertaking some steps

together to improve the process. On the US side, O’Donnell was concerned about the high prices charged for APAs, as the US is charging full hours and may not be sufficiently efficient in processing APAs. Moreover, the US is challenged by growing inventories and the fact that 20% of its bilateral APA inventory is with India and it has not been able to conclude any APA with India yet.

Following this perspective, a business panelist expressed the view that even though it takes about four years to conclude bilateral APAs, a strategic approach to APAs has generated many benefits for his company. He stressed that in this era of transparency and stakeholder focus on accountability, his company found it essential to rethink its approach. As his company is present in 50 countries, the company is continuously audited, which takes up a lot of resources. Audits generally take more than five years, which is longer than the timeframe for concluding APAs. Moreover, the quality of the auditors varies greatly and with that audits are unpredictable as to process, costs and outcome. In contrast, APA programs often have well-trained personnel allocated to them, the analyses undertaken are mostly logical, and they secure stability for a period of at least five years. Moreover, APAs with certain countries can create a halo effect for other countries. Therefore, his company decided on a strategy where they are fully transparent with tax authorities and seek certainty through APAs. As a consequence of this approach, the company has been able to lower its financial reporting provisions for audits from US\$2.8 billion to US\$475 million. The time value of money for the difference makes the APAs worthwhile, without even taking into account the positive effect the approach has had in terms of reducing reputational risk.

MacLean added that this experience reflects that there is a clear distinction between two sets of companies: those with a solid tax strategy, that are transparent and that have a strong tax control framework, and those without these characteristics.

On ICAP, the same business representative indicated he is a fan of the project. It does not give full certainty for financial reporting, but has a very strong halo effect. A low risk designation by ICAP will positively influence audit intensity. The other business representative found it a great advantage to be able to present its country-by-country reporting data, its tax policy, and its tax control framework to all tax administrations at the same time. He expressed the view that the future is in international cooperation and that companies need to adapt to that.

An important lesson learned from ICAP by the participating countries is that it is very useful to have a standardized template for the documentation required, which then is made available to all tax administrations through a shared website.

Looking forward, the panelists agreed that multilateralism, a growing international common vocabulary, more aligned risk assessments, and standardized solutions to common problems (such as pre-determined mark ups for allocating profits to routine activities) should be achievable in the future.

## Improving Tax Certainty (Part II) – MAP

This session focused on developments with respect to BEPS Action 14 on improving the dispute resolution mechanism under tax treaties. The panel included Grace Perez-Navarro, Deputy Director of the Center of Tax Policy and Administration at the OECD; Harry Roodbeen of the Netherlands Ministry of Finance; and John Hughes, Director of Advance Pricing and Mutual Agreement in the Large Business and International Division at the US Internal Revenue Service.

The session was largely devoted to a reflection of where the peer review processes on the BEPS Action 14 minimum standard stand and a presentation of the MAP statistics.<sup>3</sup>

It was concluded by the panelists that there are positive developments that can be seen following the introduction of the MAP minimum standard. These relate to access to MAP (such as in India and Brazil for transfer pricing cases), the allocation of additional resources, the improvement of time to resolve cases, and the resolution of cases. However, there are also issues that still need attention, such as the fact that many double taxation cases do not reach MAP, finding solutions for batches of similar cases in the MAP process to resolve these cases together and prevent such cases from coming up in the future, and the benefits of an early dialogue between tax authorities. Moreover, it was stressed by business representatives that given the growth in the number of pending cases, the current system of handling disputes may not be sustainable in the long run.

## Transfer Pricing

The session provided a brief update on the status of several OECD transfer pricing initiatives, including:

- ▶ Profit attribution to permanent establishments
- ▶ Profit splits

- ▶ Hard-to-value intangibles
- ▶ Financial transactions
- ▶ The country-by-country reporting review required in 2020

The panel included Tomas Balco, Head of the Transfer Pricing Unit with the OECD Secretariat, and Christopher Bello, Chief of Branch 6 in the Office of Associate Chief Counsel at the US Internal Revenue Service.

On the OECD work on profit attribution, the panelists noted that there has not been a significant increase in audit activity based on the new permanent establishment and profit attribution guidance developed in the BEPS project, but that the possibility of a permanent establishment determination and associated profit attribution by the tax authority is often used for enhancing a transfer pricing adjustment. There was some concern expressed about the new Workplan and the design of any new threshold for nexus. A panelist noted that there is a greater common understanding of principles under Article 9 (transfer pricing between related entities) than under Article 7 (profit attribution associated with business activities of a nonresident enterprise), as the latter tends to be applied differently depending on the specific treaty provisions between countries and so has greater complexity for taxpayers. This complexity is likely to increase substantially under the Workplan proposals.

Final OECD guidance has been issued on profit splits, but the topic has additional relevance in light of the Workplan's proposed modified residual profit split method. A panelist questioned assertions made in prior panels that such a method will be simple to apply, citing audit experience to the contrary, especially when the method is applied on a business line basis, and noting that even the determination of routine returns is seldom easy.

With respect to the BEPS work on hard-to-value intangibles, the panelists said that it is too early to determine the impact of this new part of the OECD Transfer Pricing Guidelines. The work on hard-to-value intangibles was based on new found interest by the OECD transfer pricing working group in the US periodic adjustment rules, because a lot of countries realized that the US rules were designed to address the intellectual property issue that was the focus of BEPS. The business panelists noted that, while the US has not often applied the periodic adjustment rules, other countries might use the hard-to-value intangibles provisions to inappropriately use hindsight in the face of high profits. In this regard, it was noted that the hard-to-value intangibles



guidance gives a lot of room to tax administrations to adjust over a long period of time, while giving very little protection and certainty to taxpayers.

On the OECD work on transfer pricing for financial transactions, Balco noted that there were over two dozen areas of disagreements in prior drafts that have now been resolved. The OECD transfer pricing working group has concluded its technical work, and is working with the OECD treaty working group on the extent to which the arm's-length principle is relevant with respect to the capital structure of a company. A number of countries would like clarification on the language in the OECD Model Tax Convention Commentary on Article 9 (transfer pricing between related entities), which asserts that Article 9 may have relevance but provides no additional support or guidance. A question to be addressed is whether the arm's-length principle could be interpreted to override domestic law interest limitations put in place in connection with the recommendations under BEPS Action 4 on interest deductibility. The OECD working group on treaties is working on refining the Commentary on this point. Once that is done, the plan is to finalize the report and release it by the end of 2019.

On country-by-country reporting, the BEPS Action 13 Report requires an evaluation of the program by 2020. Balco noted that as of today, there are over 2,000 bilateral relationships activated under Competent Authority Agreements and other mechanisms. The first batch of peer reviews of country-by-country reporting were completed last May, and the second batch will be published this summer. Issues to be discussed in the 2020 review include whether the thresholds, templates, format, and filing mechanism should be changed. More generally, it is an opportunity to evaluate the program

based on country and taxpayer feedback. Balco stated that a discussion draft will be released in early 2020, with a public consultation sometime in the first quarter of 2020. The review will be finalized by the end of 2020. Bello noted that when the review date of 2020 was set, back in 2015, it seemed like a long way off. But it means that the OECD needs to start the review now, which is difficult because there is not a great deal of information available yet. However, they hope to elicit enough information on country and taxpayer experience to be able to make improvements to the program.

## Implications

The proposals discussed on the first day of the OECD conference and reflected in the new OECD Workplan could lead to significant changes to the overall international tax rules under which multinational businesses currently operate and go well beyond digital businesses and digital business models. It is important for businesses to follow these developments closely as they unfold in the coming months, to start assessing the potential impact on their business operations, and to consider engaging with the OECD and their governments about the implications of these proposals.

At the same time, the changes in the international tax environment that have already begun to unfold with implementation of the OECD BEPS recommendations will continue to evolve. Developments with respect to increased transparency, enhanced cooperative compliance mechanisms, and improved APA and MAP programs environment are expected to continue. This activity will offer new opportunities for businesses to manage their controversy risks and to enhance tax certainty.

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## Endnotes

1. See EY Global Tax Alert, [OECD workplan envisions global agreement on new rules for taxing multinational enterprises](#), dated 3 June 2019.
2. Id.
3. For a discussion of these developments, see EY Global Tax Alert, [OECD releases fifth batch of peer review reports on BEPS Action 14](#), dated 18 February 2019, and EY Global Tax Alert, [OECD releases 2017 Mutual Agreement Procedure statistics](#), dated 23 October 2018.

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