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### **Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing**

PwC International Ltd on behalf of its network of member firms (PwC) welcomes the opportunity to share its views in reaction to the above public consultation document. In view of our understanding of the nature and urgency of the request, as well as the limited two-week turnaround, we set out below a brief summary of the issues on which we believe the Task Force and OECD could focus. We would be happy to elaborate on these further or to discuss other matters in the public consultation document.

#### **1. General points**

- Destination based tax systems have been the subject of intense research and are well-known to struggle in achieving a satisfactory outcome for the identification of the market/final consumer beyond simple cases, with particular difficulties for B2B business and component manufacturers. VAT is an exception as it is levied at every stage of the value chain and even with this characteristic, the VAT system presents some global inconsistencies now being addressed through the International VAT Guidelines.
- The Draft Model Rules are complex and pose challenges to tax administrations and businesses in terms of implementation and compliance. In particular, relying on a transaction-by-transaction approach may require businesses to rethink their compliance systems in a substantial way implying a large investment of resources that is unlikely to be justified by the extra revenue raised. The balance between the need for accuracy and the need to limit compliance costs may still need further consideration, also considering that most countries of the Inclusive Framework have VAT systems in place which raise revenue in markets without requiring a complete new system of compliance.
- The multilateral convention needed to implement rules that will override bilateral treaty provisions will need to be reconciled with those treaties as far as possible, despite recognition that the Model nexus and sourcing rules would apply solely for the purposes of Amount A. There are issues that may require further clarification in this regard. For example, the relationship between

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the revenue sourcing rules of Amount A and the sourcing rules under the domestic law and/or tax treaties is not entirely clear under the draft Model Rules.

- Uncertainty exists about the administrative process. There is a concern that the sourcing and nexus rules imply MNEs will need to interact with a very large number of individual countries, even where they have no entity or PE, despite the identification of a lead tax administration. This would become a very resource-intensive process for both taxpayers and tax administrations.
- One possible - and workable - solution could consist in developing safe harbour elections into the allocation keys. Such safe harbour rules would enhance simplicity and certainty. Safe harbours could be construed as a right balance between accuracy, complexity and detail on the one hand and administrability and certainty on the other.

## **2. Nexus test**

- While we understand that the thresholds have been the subject of political discussion, their interaction with the sourcing rules suggests that on boundary issues there could be disputes and the resolution process will need to be carefully defined.

## **3. Source rules**

General points

- Obtaining information from customers regardless of their size - be they distributors, resellers or other businesses - will be difficult in a number of ways. These will include concerns about disclosures of confidential business information, the legality of passing on certain information and the commercial implications of doing so. The nature of the information will likely be inconsistent between businesses as well. Could this issue be resolved by limiting the definition of "Final Customer" to the customers of the MNE and using a reliable indicator based upon the location of the MNE's customer or the location of delivery by the MNE?
- The extent to which in-scope MNEs will have to carry out due diligence in obtaining the information from third parties will need to be explicit and should only cover basic logic checks. The auditability of information received from customers will be problematic for Tax Authorities.
- It should be made clear whether there will be a 'formal hierarchy of indicators'? Does it, for example, mean the proposed list for the seven categories would/ must apply first; then and only if that does not provide an answer, use of taxpayer's own transactional indicators; finally, if there is still no answer, the use of global allocation keys? That should also incorporate the expected level of justification should the taxpayer anticipate the need to move through the hierarchies.
- MNEs do not always have information on a transaction-by-transaction basis. This implies that business will need to put in place new systems for making transaction-by-transaction type data available. In this context, it is important to consider whether the approach is proportionate in comparison to the additional compliance costs and obligations created by the rules.
- There is a potential inconsistency or contradiction in applying the 'predominant' category of revenue rule and the separate country rule (e.g. where set out in one invoice) and it should be clarified and/or a standard should be established to determine when one or the other criteria shall apply first. The transaction-by-transaction approach also raises questions on how the



'predominant test' applies to embedded transactions where, for instance, goods and services are provided on a package basis instead of an itemised basis. Could a higher threshold or safe harbour be used to avoid these issues and the related complexity that would have to be built into IT systems to deal with them?

- Clarification is needed of the meaning in relation to a 'reliable indicator' of verification in another manner that is functionally equivalent to use for commercial, legal, regulatory or other obligations.
- Reference to "Article 5" in relation to Another Reliable Indicator is presumably to the Revenue Sourcing Article as set out in this document.
- Many of the Reliability Indicators reference "use". but this may be ambiguous in some instances, e.g. the place a service is performed or where the benefit of the service is intended.
- Transaction types that are immaterial for MNEs could be exempt from revenue sourcing in order to reduce the overall complexity in implementation for those MNEs and for the Tax Authorities. A materiality threshold (for example, a percentage of an MNE's global revenues or fixed amount) per transaction type or overall would reduce the number of separate revenue sourcing analyses.

#### Specific sources

- For 'Finished Goods' and the 'Sale of Finished Goods to Final Customers through an Independent Distributor' it is noted that the location of an independent distributor may be used contingent on the fact that the jurisdiction is contractually restricted or it is reasonable to assume that the location is the same as the final customer. This restriction effectively nullifies this reliable indicator as many MNEs cannot restrict its customers nor attest that the location of the final customer (of which it has no visibility) is the same. This reliable indicator could be expanded to include "delivery address of the independent distributor" as this would be more commensurate with the location of the final customer.
- Recognition of the need for special rules for 'Components' (with more guidance still to come) could perhaps reflect that any form of tracing is possible only for items that are transformed by the buyer prior to selling to a customer as a finished good - something akin to substantial transformation for Subpart F in the US tax system perhaps? There are definitional issues as regards components and finished goods, for example parts that are used to make audio speakers could be components and those speakers could be components, as they are assembled in building sound systems, but might also be considered finished goods.
- In relation to 'Transport Services', interpretation is needed of the "transactional level". The choice between the "place of origin" and "place of destination" is unclear - the meanings are uncertain; there seems to be inconsistency insofar as for passenger services the source rules refer to the place of destination while for cargo services, reference is to the place of origin or the place of destination; and it doesn't seem to cover a package journey with multiple stops. Transactions that cover both "Air Transport Services" and "Non-Air Transport Services" to complete a journey do not easily fit either. Would it be preferable to have broader allocation keys to encompass all reliable transport methods?
- In the event of 'Online Services' being provided to a customer that is operating in different jurisdictions and that utilises these online services simultaneously in a range of jurisdictions,



questions are raised as to how the revenues earned from these services should be sourced to individual markets under the envisaged sourcing rules.

- For 'Business to Business Services' revenues, in order to apply the 'Headcount Allocation Key', the MNE must take reasonable steps to obtain the jurisdictional breakdown of headcount of the large business customer (LBC). This is usually not information that will be available or that the LBC will likely be ready to give.
- With 'Intangible Property' (IP), it would seem that the place of use is the same place of use as the goods in which the IP is embedded. Perhaps it would be simpler to combine the approaches. It seems inconsistent that the sourcing rules do not contain a materiality threshold for transactions involving IP.
- The 'Real Property' category could perhaps align more closely with immovable property as used in the Model Tax Convention. Determining the location of such property on the basis of the jurisdiction granting the right to exploit that property seems to rely more on a traditional source interpretation and not always obviously meet the objective of attribution to the market state in which the user or consumer is located.
- If the 'Non-Customer' category were to apply for a wide range of things including investment income (not from the supply of financial services) it is difficult to see how splitting it across the categories of other revenues makes any sense where it is a significant part of the business.

#### 4. Other points

- Can it be left to the role of the "panel", rather than burying the MNE in red tape, in trying to carry out any form of due diligence on third party data? If the MNE demonstrates it has an internal control framework, it is not unreasonable for the panel to agree that the framework is adequate or disagree if it chooses to do so with an appropriate appeal process.
- Although affected MNEs are required to document their approach to revenue sourcing at a systemic level instead of at an individual transaction level, corresponding system adaptations could still be a massive undertaking. To minimise the compliance burden, a pre-clearance of data collecting techniques would be appropriate as this could provide some level of certainty to businesses before rebuilding their systems.
- In general, and in light of the complexity and administrative challenges, we recommend that the revenue sourcing rules should provide more flexibility to taxpayers so that they may be able to utilise *existing* systems, information and data sources to comply with the key principles underlying the sourcing rules (rather than having to invest in new systems and have to alter ways of contracting with unrelated counterparties).
- In the interest of the aforementioned flexibility, and given the sheer volume of contracts and transactions (e.g., in the case of B2B services, online intermediation services, transportation services, etc.) that many taxpayers will have to contend with, it may be prudent to allow for some form of aggregation, statistical sampling and other approaches in the applications of the sourcing rules. This could be done in a manner that adheres to the overarching principles and relevant indicators/keys for the specific categories of transactions. There may be a parallel here with the U.S. foreign derived intangible income (FDII) regulations which also require the application of sourcing principles on a destination basis to transactions. The FDII rules, which may be instructive in the present context, allow for statistical sampling approaches and may provide a



useful example in the context of the Pillar One revenue sourcing rules in light of the administrative and implementation challenges discussed above. The statistical sampling and other estimation approaches could be part of the “systems level” documentation that would have to be maintained by a Covered Group to demonstrate compliance with these rules.

## 5. Conclusions

- Significant work needs to be done if the system is to be more workable, e.g., by looking at safe harbours or alternative approaches.
- The current proposal, by relying very heavily on a transaction-by-transaction basis, risks requiring a disproportionate compliance burden. It is unclear why this is needed when the avoidance opportunities of different approaches and the additional revenue raised are probably minimal.

If you would like to ask for additional information on, or explanation of, any of the points made above please do not hesitate to contact me or one of the individuals set out below.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Stef van Weeghel".

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