

OECD launches Public Consultation on Pillar One draft Model Rules on Revenue Sourcing and Nexus

8 February 2022

In brief

On 4 February 2022, the OECD released [draft Model Rules](#) with respect to nexus and revenue sourcing under Amount A of Pillar One. Comments to the draft Model rules are due by 18 February 2022. This alert provides a short overview of the draft Model Rules and some initial observations. It should be noted that this is the first in a series of several sets of rules that the OECD is expected to release over the coming months, with very short comment periods, as part of a 'rolling consultation'.

In detail

Background

Under Pillar One, a formulaic share (Amount A) of the consolidated profit of certain multinational enterprises (MNE) will be reallocated to markets (i.e., where sales arise). Pillar One will apply to MNEs with profitability above 10% and global turnover above EUR 20bn. The profit to be reallocated to markets will be calculated as 25% of the profit before tax in excess of 10% of revenue. In that regard, Model Rules will be developed for all aspects of Amount A to provide a template that jurisdictions can use, if necessary, to give effect to the new taxing right in their domestic legislation. After receiving input from stakeholders, the draft Model Rules will be revised, and translated into the Multilateral Convention (MLC) and an accompanying Explanatory Statement for approval by the Inclusive Framework (IF). The goal is for the MLC to be open for signature by mid-2022.

The Model Rules will consist of different titles. The draft Model Rules just released cover nexus and revenue sourcing, which are linked because the results from revenue sourcing are used to determine whether the nexus condition is met. Draft Model Rules on tax base and surrendering and ceding entities are expected to be released at a later stage.

Nexus

The introductory statement to the draft Model Rules provides that the new special-purpose nexus rule applies solely to determine whether a jurisdiction qualifies for profit reallocation under Amount A and will not alter the nexus for

any other tax or non-tax purpose (i.e., designed as a standalone provision to limit any unintended spill-over effects). To determine whether a 'Covered Group' (i.e., an MNE in-scope of Amount A) satisfies the nexus test for Amount A in a jurisdiction, it will have to apply the revenue sourcing rules, which identify the jurisdiction in which revenue arises for purposes of Amount A. As agreed by the [IF last year](#), the nexus threshold will be EUR 1m for jurisdictions with annual GDP equal to or greater than EUR 40bn and EUR 250k for jurisdictions with annual GDP of less than EUR 40bn. Note that the MLC will outline an agreed approach to currency fluctuations.

Revenue Sourcing

The introductory statement to the draft Model Rules provides that the revenue sourcing rules provide a methodology for a Covered Group to use available information to reliably identify the market jurisdiction based on a range of possible indicators, or, in cases where a 'back-stop' is needed, based on an allocation key that is expected to provide a reasonable approximation of the market jurisdiction. The consultation document argues that 'back-stop' allocation keys are provided to ensure that no revenue goes unsourced (particularly important for third-party distribution arrangements, components, certain services, and intangible property). The revenue sourcing rules include a legislative article that articulates the sourcing approach, supported by a schedule setting out the detailed rules for applying the revenue sourcing principle for the type of revenue in question. The legislative article and schedule are intended to be binding.

The primary rule is that revenue must be sourced on a transaction-by-transaction basis according to the category of revenue earned from the transaction. This means that for each item that generates revenue, the Covered Group must determine where the revenue item should be sourced. The 'transaction' is the item that generates income (e.g., the individual item of inventory or the 'clicks' on an online advertisement), and it does not mean the invoice. If there are different items or services contained on one invoice or contract and goods or services are sold in different jurisdictions, the revenue allocation must be in proportion to the revenue earned in each market (rather than an equal split). Moreover, if a contract specifies different prices for the different locations, then these pricing differences must be considered. Commentary is expected to provide further guidance on the transaction-by-transaction approach, with examples of common cases where pricing differences are likely to be relevant.

The draft Model Rules include sourcing rules for eight different types of delineated revenue categories. Transactions comprising different elements that fall under more than one revenue category are sourced according to their predominant character.

Covered MNE Groups must source all revenue, and revenue must be sourced using a 'reliable method' (i.e., using a reliable indicator or an allocation key) based on the Covered MNE Group's specific facts and circumstances. The draft Model Rules recognize that, despite best efforts, a Covered Group may not be able to isolate the source for every transaction (e.g., tail-end revenue, components, B2B services), and in such case an allocation key is provided. For transactions involving the sale of components, the draft Model Rules require revenue to be sourced to the place of delivery of the final customer of the finished good into which the component is incorporated. If this cannot be determined by using a reliable indicator, the Global Allocation Key must be used.

Summary overview of revenue sourcing rules by revenue category

Revenue Category	Sourcing rule
Transactions for the sale of Finished Goods sold to a Final Customer	Place of delivery of the Finished Goods to that Final Customer
Transactions for the sale of Digital Goods	If the Final Customer is a Consumer, Location of the Consumer. If the Final Customer is a Business, place of use of the services. (Except if Digital Good is a Component)
Transactions for the sale of Components	Place of delivery to the Final Customer of the Finished Good into which the Component is incorporated
Transactions for the provision of services	
<ul style="list-style-type: none"> • Location-specific services 	Place of performance of the services
<ul style="list-style-type: none"> • Advertising services 	For online Advertising Services, Location of the Viewer. For other Advertising Services, the place of display or reception of the advertisement.
<ul style="list-style-type: none"> • Online intermediations services 	
<ul style="list-style-type: none"> ○ That facilitate the sale or purchase of tangible goods, Digital Goods or Digital Services 	Half of the revenue in the Location of the Purchaser and the other half of the revenue in the Location of the Seller
<ul style="list-style-type: none"> ○ That facilitate the sale or purchase of Offline Services 	Half of the revenue in the Location of the Purchaser and the other half of the revenue in the place where the service is performed
<ul style="list-style-type: none"> • Transport services 	
<ul style="list-style-type: none"> ○ Passenger Transport Services 	Place of the Destination
<ul style="list-style-type: none"> ○ Cargo Transport Services 	Place of Origin or the Place of Destination (allocation key)
<ul style="list-style-type: none"> • Customer reward programs 	Proportionality to the Location of the Active Members
<ul style="list-style-type: none"> • Provision of Financing 	If the borrower is a Consumer, Location of the Consumer. If the borrower is a Business Customer, place of use of the services.
<ul style="list-style-type: none"> • Business to Consumer services 	Location of the Consumer
<ul style="list-style-type: none"> • Business to Business services 	The place of use of the services
Transactions for the licensing, sale, or other alienation of:	
<ul style="list-style-type: none"> • Intangible Property (IP) 	Place of use of the service supported by the IP; or place of use of the IP by Final Customers in all other cases
<ul style="list-style-type: none"> • User data 	Location of the User associated with the data
Real property	Location of Real Property
Government Grants	Jurisdiction that made or funded the Government Grant
Non-customer revenues	In proportion to the other revenues arising under the above categories of revenue

Approach to compliance / documentation

The approach to compliance is at a systems level and not at an individual transaction level. Per the introductory statement, this means showing a clear, internal control framework demonstrating the Covered MNE's conceptual approach to revenue sourcing, how it obtains the necessary data, and how it monitors the accuracy of that data via internal checks (all of which will be elaborated in standardized documentation requirements in the final Model Rules).

The takeaway

The introductory statement provides that the draft Model Rules have been designed to balance the need for accuracy with the need to limit compliance costs. It is not clear, however, that the draft Model Rules have achieved that goal. Although the consultation document notes that the approach to compliance is at a systems level, businesses will still need to make system adaptations to track every transaction line by line on their invoices (and capture price differences in different markets). Particularly for the very large MNEs currently in scope, this will be a massive undertaking – perhaps not fully appreciated by the government delegates. Based on the successful business experience during BEPS with Action 13 (a country-by-country (CbC) reporting initiative, pursuant to which large MNEs are required to prepare a CbC report with aggregate data on the global allocation of income, profit, taxes paid and economic activity among tax jurisdictions in which they operate), business should, therefore, explain what can be done with existing systems, and the very significant changes that would be required to collect this new data.

Should the transaction-by-transaction approach survive, then given the systems changes that will be required, a preclearance of data collecting techniques would be appropriate. This will provide some level of certainty before the expense of rebuilding ERP systems. Even with safe-harbours and tax certainty on the indicators, however, the sourcing rules are expected to be exceedingly complex to administer (both for businesses and tax administrations).

In addition, the relationship between the sourcing rules in the consultation document and domestic and/or tax treaty sourcing rules is an issue that perhaps needs to be clarified in the Model Rules. The transaction-by-transaction approach raises questions on how the 'predominant test' applies to disentangle embedded transactions where, for instance, goods and services are provided on a package basis instead of an itemized basis. In the event of (online) services being provided to a customer that is operational in different jurisdictions, and which utilizes these (online) services simultaneously in a range of jurisdictions, questions are raised as to how to divide any revenues earned from these services to individual markets under the envisaged sourcing rules.

Finally, while in many cases the OECD has sought to rely on business practices to source revenue, some of the provisions may still result in subtle changes. For example, in relation to the provision of business-to-business services, a service provider may not be able to rely on the billing address to source revenue, but can rely on a location identified in a contract. However, that latter requirement may change, albeit only slightly, the relationship between provider and customer.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Tax policy leadership

Stef van Weeghel, *Amsterdam*
+31 0 88 7926 763
stef.van.weeghel@pwc.com

Will Morris, *Washington*
+1 202 213 2372
william.h.morris@pwc.com

Edwin Visser, *Amsterdam*
+31 0 88 7923 611
edwin.visser@pwc.com

Regional tax policy leaders

Stewart Brant, *PwC United States*
+1 (415) 328 7455
stewart.brant@pwc.com

Maarten Floris de Wilde, *PwC Netherlands*
+31 6 341 96789
maarten.floris.de.wilde@pwc.com

Vassilis Dafnomilis, *PwC Netherlands*
+31 6 139 98729
vassilis.dafnomilis@pwc.com

Tax policy editors

Phil Greenfield, *London*
+44 0 7973 414 521
philip.greenfield@pwc.com

Chloe O' Hara, *Dublin*
+353 87 7211 577
chloe.ohara@pwc.com

Giorgia Maffini, *London*
+44 0 7483 378124
giorgia.maffini@pwc.com