

Public comments on OECD Blueprints for Pillar One and Pillar Two

January 21, 2021

In brief

Businesses, advisers, trade organisations, academics, and NGOs were eager to ‘have their say’ in relation to the Blueprint Reports for Pillar One and Pillar Two frameworks seeking adjustments to the international tax system to meet the challenges of digitalisation/ globalisation. The OECD received more than 200 response letters with 3,500 pages of comments (marginally more on Pillar Two than on Pillar One), and the virtual public meetings featured over 3,000 viewers.

- PwC’s written comments pointed to matters of principle that we thought should be followed, as well as suggestions for simplification such as including viability testing and a netting process between countries to facilitate the required re-allocation of tax revenues. We also dealt with a number of technical issues, including certainty and interaction with transfer pricing rules, plus matters of administrative implementation.
- Other commentators focused on a wide range of subjects covering, for example, alternatives to the Amount A formulation, the narrow/ broad scoping of Amount B, and the political issue of the level of the minimum tax for Pillar Two. The OECD Secretariat said the main thrust was the need for reducing both the inherent complexity of what is being sought and the practical complexity of making changes work.
- The Chairs of the virtual meeting noted that simplification has already played a big role in discussions and will remain important. Fundamental policy issues remain open, such as scope of Amount A and rates, benchmarks and thresholds. However, forward movement on these issues will require involvement of the new US administration, so there may be a short delay before that can happen but, in the Chairs’ view, there is a solid foundation for future consensus.

In detail

Background

As part of the ongoing work to develop a solution to the tax challenges of the digitalisation/ globalisation of the economy, the OECD/G20 Inclusive Framework on BEPS published Blueprint Reports in October, with a deadline for comments of 14 December and held two days of virtual public meetings on 14 and 15 January. These public consultation meetings sought to focus on the key questions identified in the consultation document, particularly regarding simplification options and ideas.

The IF and G20 have agreed a period to the end of June to reach a political consensus. Individual countries and collectives, like the EU, have largely agreed to see whether this deadline can be met before considering further 'unilateral' actions.

Our submission and contribution to the public meeting

In PwC's [submission](#), we devoted eight pages to high level points before setting out in three Annexes specific responses to the technical questions raised and other thoughts we believed constructively sought to move matters forward on the Blueprints. We were also invited to speak as part of the [public consultation meetings](#), on Day 1 as part of panel two on Tax Certainty and Administration, particularly as regards Amount B. Some of our key points related to the following:

- Taking time to embed clear principles into the Pillar One framework could give ongoing political negotiations a stronger purpose that may well lead to a greater sense of international understanding and commitment over the long term.
- The Amount A application may benefit from either a far more narrow scope of the activities subject to Amount A, or on the other side of the spectrum from a very wide scope, i.e., by including in-scope all MNEs with global revenue above an agreed threshold.
- For Amount B, the OECD Transfer Pricing Guidelines could play a key role in determining benchmarkable marketing and distribution activities using qualitative and quantitative indicators. An appropriate return on sales, based on the local sales function relative to turnover could be corroborated by the Berry Ratio. To accommodate high volume/ low margin (or vice versa), an activity test could be combined with an ability to pay test, with the result applied to earnings before interest and tax (EBIT).
- If Pillar Two is not dramatically simplified, it will fail to achieve its objectives. Regarding one aspect of this, we suggest the IF consider expanding the scope of the dispute prevention/ resolution panels that are established for Amount A to the determination and allocation of the GloBE top-up tax.
- A netting system between governments is a simplification with precedent in the VAT area. If taxpayers provided limited data on user/ customer locations, countries could use their current accounts with the IMF to make net transfers based on whatever is decided for determining Amount A.
- Viability testing via a pilot programme could rationally stress test the system to ensure the process and outcome align with the agreed policy objectives and is supported by IF members. Before changing treaties and domestic legislation, it could apply for a certain period and with a small number of MNEs and tax administration (e.g., ICAP volunteers) followed by an intense review of the results subject to IF approval.

Other comments on Pillar One

Key themes

Several key themes appeared to surface:

- Continued support for international consensus-based solution
- Questions about policy objectives and principles particularly underlying Pillar One
- Calls for greater simplification
- NGOs consider reform too narrow – especially regarding the amount of profits to be redistributed

Amount A - scope, nexus and sourcing

- There seem to be divergent views on scope. Some commentators are arguing for a wider scope (particularly NGOs); others are seeking a modification to existing scope, particularly around industries such as pharma, franchise models, etc. On automated digital services (ADS), a number of people raised challenges around B2B cloud computing and other ADS services. The OECD suggested 'a small number' favour a US safe harbour approach, some suggested an ADS-only scope, while more argue for transition/ phase-in rules (starting with larger businesses, ADS, voluntary/trial approach, etc). Finally, some request the IF to identify the underlying principles. Some alternative approaches also have been proposed.
- There is broad support for the Blueprint's de minimis in-scope revenue exception but recognition that there are challenges in defining what is domestic. The OECD said there was 'large support' for a global revenue threshold in excess of EUR750m (while others argue for a phased-in approach starting with larger MNEs).
- On nexus and revenue sourcing, a market revenue threshold for nexus was popular. Concerns were expressed that nexus 'plus factors' would create excessive compliance costs. The Blueprints's revenue sourcing priorities seemed to be broadly accepted but need more flexibility on hierarchy, concerns around B2B transactions including third party distributors, and a number of technical concerns around IP address and geolocation within ADS.

Amount A - tax base

- There were no significant challenges to the use of consolidated financial accounts but recognition that Amount A can't always be calculated from consolidated financial accounts. The OECD said there was a 'strong preference' for using disclosed segments where possible. Most commentators seem to consider hallmarks to be subjective and complex to apply (risk of uncertainty). Support for the Blueprint's proposed earn-out approach to carry forward losses was almost unanimous with widespread support for accounting for pre-regime losses and profit shortfalls. Most suggested loss carry-forwards should not be time limited.
- On double counting, there was widespread support for the marketing and distribution profits safe harbour and some support for the domestic business exemption in concept, though questions were raised about whether it could feasibly be developed and applied in practice. Business and advisors were particularly opposed to applying Amount A on top of withholding taxes.
- On elimination of double taxation, some concerns were expressed about complexity leading to double taxation and increasing disputes. There was broad, but not universal, support for an activities test over a profitability test. The market connection priority test had some support but concerns related to complexity. Business and advisors prefer the exemption over the credit method.

Amount B

- On Amount B, the OECD suggested there was strong support for the stated objectives but views diverged on how Amount B should be developed. Simplification should not automatically override existing valid principles. One commentator commissioned a benchmarking study on Amount B and found that the returns on this activity globally are in a very narrow range. Some of the alternatives raised include:
 - 1% minimum return on sales (ROS) where an MNE's pre-tax margin is very low
 - ROS range between 1% and 2.5% up to a benchmark pre-tax margin (12.5% illustrated) consistent with arm's length pricing for enterprises with no excess returns
 - higher ROS based on an embedded, redesigned Amount A.
- On addressing double counting issues clarification is needed regarding how a fixed return and Amount B currently interact.

Tax certainty

- Mandatory binding dispute prevention and resolution for Amount A received widespread business support. The main challenges relate to timing and resource burdens as well as thresholds and simplification. Improvements to the Amount A tax certainty process were suggested.
- There was also broad support for mandatory and binding dispute resolution beyond Amount A.
- Caution was noted by some members of the IF and NGOs regarding certain elements of dispute resolution (i.e., sovereignty considerations, etc.).

Other comments on Pillar Two

There appears to be broad support from respondents and speakers on the concept of Pillar Two, at least as regards certain base erosion (GloBE) objectives, but there is also considerable recognition that it may be difficult to implement with some of the features included in the Blueprint. If and when there is further clarity, a number of people supported the idea of a phased implementation such as applying a higher threshold to limit the number of MNEs affected in the first year and gradual reductions to reach an agreed level. A number of specific industry comments identified the suggested need for special rules or carve-outs for shipping and investment funds. Some of the other comments could be aggregated as follows.

Effective tax rate calculation

- For the calculation of the effective tax rate (ETR), comments suggested that the consolidated financial statements were largely agreed as the most reasonable starting point. Portfolio dividends and reorganisations were among the matters for which permanent adjustments would then be required. Many thought covered taxes should include any digital services taxes or similar sectoral levies (though people were generally looking for confirmation that such taxes would not be permitted or, if already introduced, would be repealed). Support was expressed for some sort of simplified gateway test, based on information submitted in CbC reports, a whitelist of jurisdictions or similar (the OECD suggested this could mean use of that process rather than necessarily the current datapoints since there was some concern about the high-level risk assessment purpose of the CbC reports). There were respondents on each side of the arguments about substance carve-outs.
- There were a large number of references to timing differences and the use of carryforwards versus deferred tax accounting. The OECD explained many countries saw deferred tax as something of a 'black box' and difficult for them to audit/review. Others pointed out the quasi-regulatory nature of what is a long-standing concept. The working party

was also concerned that it would allow expected liabilities to be taken into account giving MNEs a benefit for the time value of money along with some indefinite deferrals outside policy decisions on capital investment.

Simplification options

- Tax administrative support was most commenters' first choice for a stable and easy, non-political process, with lower levels of support for a CbCR ETR gateway test (mentioned above) and exclusion for entities with a de minimis level of profits (a relative percentage preferable to an absolute figure). The multi-year approach was the least favoured option.
- One organisation proposed, as an alternative to a substance based carve out, a transfer of the payments out to substance-based locations where they would then be taxed at their own statutory rate and therefore given parity. The rule would also include sales as a factor additional to the employment and assets keys – sales revenues could be used from Pillar One.

Specific rules, rule coordination and interaction with other domestic rules

- There appears to be a preference for the top-down approach to the income inclusion rule (IIR), largely on the basis that it is a comprehensive rule, more targeted and easier to administer.
- Some thought the Blueprint's undertaxed payments rule (UTPR) is overly complex. There would also be a need further to prevent overlap with IIR rules and between allocation keys, perhaps with examples in guidance. A popular view was that it should be deferred for some period of time to allow countries to implement their IIRs. It was also expressed that UTPR should only apply to wholly artificial rules in order to comply with the EU freedoms.
- The subject to tax rule (STTR) was the most controversial topic addressed. The annualised charge possibility was considered preferable to a withholding procedure with a lower rate than the minimum tax rate being applied, but IF members argued over whether it should have priority.
- The need was expressed for model legislation or a multilateral convention to ensure consistency and coordination.
- It was further speculated that the rules should dictate the repeal of various domestic anti-avoidance rules that would no longer be necessary (including, say, switching off the US BEAT rules in these circumstances). Many specific points were raised in relation to US GILTI, particularly as regards whether to treat it as a qualified IIR given its global blending approach.

The takeaway

The OECD has been looking closely at a number of simplification options, for both Pillar One and Pillar Two. The IF steering group and member countries will consider potential next steps, including in a public IF meeting on 27-28 January. Of the pending issues to be determined at a political level, the question of scope for Pillar One is probably the most difficult to resolve; it remains to be seen if a move away from the ADS/CFB definitions is possible. Countries don't necessarily need a consensus within the IF in order to implement the concepts of Pillar Two within their own domestic rules, but the IF framework provides a necessary basis for rule coordination and wider consistency.

Let's talk

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

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