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Introduction

PwC International Ltd (PwC) welcomes the opportunity to share its views in reaction to the OECD secretariat's consultation paper on the unified approach under Pillar 1 of the Work Programme on the Tax Challenges of the Digitalisation of the Economy.

General Remarks

It is clear that the OECD/G20 Inclusive Framework's "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy" ("Work Programme") entails the most significant reforms of the international tax system in decades, namely a reallocation of taxing rights and the introduction of a global minimum tax. This effort is made even more ambitious and significant because of the aim to produce a final report to the G20 by the end of 2020 — a mere 13 months away. Although we understand the ambitious deadlines from a political perspective, we urge the Inclusive Framework ("IF") to strive for full consensus on all aspects of the Work Programme before seeking final endorsement by the G20. Rules to avoid double taxation, to prevent and resolve conflicts, administrative rules, and ordering rules are instrumental to make the new framework effective and to prevent the chaos the IF envisages if the challenges are not addressed in a multilateral setting. In addition, it is pivotal that the process for both Pillar 1 and Pillar 2 results in minimum standards that are implemented via a binding international public law instrument.

While we appreciate the great deliberations undertaken by the IF in this process, some of the concerns that we have previously expressed remain. We encourage the OECD to look again at these concerns against the backdrop of the firmer unified proposal.

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A Need for Clear Objectives

The “Unified Approach” appears to have dual expressed objectives:

- to provide a uniform method of taxing highly digitalised business models in lieu of unilateral non treaty-based measures, and
- to adopt formulaic approaches where the arm’s length principle is not delivering the outcomes that countries are satisfied with in some cases, “notably because of the digitalisation of the economy”.

If we understand the proposed three-tiered profit allocation approach correctly (being mindful of the current political backdrop), there seems to be a third objective, namely to always be able to tax market presence (Amount A) regardless if there is physical presence or not and regardless if the Arm’s Length Principle (“ALP”) works as intended or not.

Clearly articulating the fundamental motivating purpose of Pillar 1 is critical to ensuring that the proposal is the most appropriate available, and the consistency and stability of its application, as well as the ability of stakeholders to measure progress against defined goals. We encourage the Secretariat to articulate more fully the objectives of Pillar 1 and ensure that all constituent elements adhere to them as work moves forward.

Executive Summary

PwC appreciates being able to provide our perspective on the questions posed in the Consultation Document. As a general remark, the principles, goals, and scope of the Pillar 1 “Unified Approach” will need further clarification to allow for informed stakeholder input as many design elements and important details have not yet been settled. At present, that means that uncertainty, increased tax disputes, and disproportionate compliance burdens may arise in the absence of more precision and transparency. A summary of our comments follows.

A. Scope

- The boundaries in defining consumer/user facing activities are unclear, with competing tensions to avoid ring-fencing the tech sector while not expansively scoping in businesses.
- Any scope limitations should consider the role of intermediaries and the fact that companies that do not directly interact with consumers may not have reliable location information.
- Maintaining a high threshold for MNE groups to be in scope will still allow for a high percentage of sales/income to be subject to the new rules — 93% for a sample we took using the €750m global turnover Country by Country Reporting (“CbCR”) threshold — and would limit the compliance burden on tax authorities and less-resourced businesses.



- Carve-outs are appropriate when they are based on an economically rational and agreed set of principles.

B. New Nexus

- A new taxing right should only apply where a company has a substantial market presence in a sustained manner over a period of years.
- The sales to be taken into account for the group threshold should be restricted to sales within any scope limitations and an adjustment year on year to account for inflation.
- Local activity should be ignored.

C. Calculating Amount A group profits

- Consolidated financial statements may be a promising starting point for calculating group profits, but there could be pressures on taxpayers' ability to pay and on governments' tax policy decisions in relying on accounting standards. For these reasons, the application of an Amount A based on accounting standards should arguably be modest and limited to a small number of entities.
- Although figures higher up in the profit/loss statement produce more homogenous results, profitability measures chosen lower down the profit/loss statement better account for taxpayers' ability to pay and better recognise investment decisions which are crucial for sustaining growth in the economy.
- Segmentation can be used to prevent more profitable business lines and markets from subsidising low profitability business lines and markets. But segmentation poses many challenges and may not fit all MNE groups, suggesting companies be given latitude to calculate segment information based on business judgment and data availability as long as consistent and reasonable methods are used.

D. Determining Amount A

- A formula without strict guardrails is likely to be subject to pressure for constant change in the future to permit greater Amount A determinations.
- A possible single benchmark profitability rate that is too low (e.g., between 5% and 7%) would result in approximately half of the population of firms in all regions being subject to Amount A allocations. This would amount to a considerable shift of the current corporate tax system towards taxing at destination. A benchmark of around 20% would be more targeted at the top of the distribution and still affect a sizeable amount of total profits.
- Using a one-size-fits-all measure for profitability could introduce distortions in the tax system so it may be necessary to have benchmark profitability rates by sector; one analysis shows a large variation ranging between 3.1% for Services and around 24% for Finance, Insurance and Real Estate.

E. Eliminating double taxation under Amount A

- Avoiding double taxation will require complex sourcing rules, identification of the entity(/ies) liable for Amount A tax, and a relief mechanism (a mechanism for correlative adjustments, and/or exemption or credit) in surrender jurisdiction(s).
- For administrative efficiency, an MNE group's ultimate parent should be permitted to make an election of responsibility for all market allocations.

F. Amount B

- This return allocation might create a description of qualifying routine or baseline marketing and distribution activities based upon the guidance developed for the sample Memorandum of Understanding on low-risk distribution services or by some other method, such as by reference to the functionality and risk profile of a typical third party distributor taking on common distributor functions the Amount B is seeking to approximate.
- An alternative approach could be the use of the franchise method.

G. Amount C and dispute prevention/resolution

- Existing dispute resolution tools are not scalable for widespread use on a multilateral basis.
- Mandatory binding arbitration, although not popular with some IF members, still presents the most promising manner to encourage timely resolution, and can be structured to avoid certain sovereignty concerns.
- Better guidance and a simpler Advance Pricing Agreement ("APA") programme should be developed for more routine activities.
- For Amount A, consider a "home state determination" whereby the MNE parent jurisdiction is taking authority for calculating and allocating Amount A to each market jurisdiction, filing returns, and performing any audit, complemented by a new multilateral approach that uses the existing competent authority network and is overseen by a body such as the Forum on Tax Administration or regional organisations of tax administrations.

The OECD's Secretariat Proposal for a Unified Approach proposes a system of unprecedented complexity, and additional work is needed on a great number of workstreams before any workable solutions can be drafted. There is a critical decision to take: is the "Unified Approach" a viable one that can be universally implemented, including by developing countries, and accepted by the jurisdictions that stand to lose tax base, or do we need a radical change of direction back to a principled approach that does not deviate from the ALP (e.g. the franchise approach, see our response to question 6.b), or to even a more radical but maybe less economically coherent



approach of supplementing the ALP with a deemed destination based remuneration for market presence that is coordinated on a multilateral basis.

Question 1. Scope

There appears to be some disagreement among IF members regarding the intended scope of Pillar 1, with some countries favouring going beyond the ALP only to address concerns raised by highly digitalised business models, while others see a broader need to address non-routine returns related to branding and marketing activities, and others a need to address non-routine returns even more fundamentally. This disagreement must be concretely resolved as the lack of clarity has caused significant confusion in the business community and is likely to be a barrier to further progress among the IF to the extent it is unresolved.

Given the radical nature of both the three overarching proposals put forward in the January 2019 Policy Note and the three profit allocation methods outlined in the May 2019 Work Programme, it is not surprising that the “Unified Approach” is also radical. There are dangers in trying to combine elements of each proposal to reach a political compromise if the underlying principles of each proposal cannot be combined coherently. The cost of this incoherence will flow through to the compliance, administration, and (most importantly given the context) the long-term stability of the international tax system. These risks should be weighed against the perceived benefits.

Regardless of these broader concerns, we have sought to provide comments on the Scope of the “Unified Approach” helpful in furthering its development and improving the certainty and administrability of such an approach.

Question 1.a. Consumer/User Facing Business

There is little clarity about how the boundaries of the term “consumer/user facing” should be drawn to achieve the objectives of the “Unified Approach.” In part, this is because the underlying principles and objectives are not detailed. Focusing on the challenges that need to be addressed rather than the principles that should form the basis for allocation provides considerable scoping challenges.

Paragraph 19 of the Consultation Document provides the most relevant guidance for “consumer/user facing” by describing the main attributes of such a business as: (1) engagement and interaction with consumers/users, (2) collection and exploitation of consumer/user data, (3) significant marketing and branding, and (4) ability to use digital technology to develop a consumer/user base.



Much additional guidance is required for taxpayers and administrators to be able to identify transactions and business models that are consumer/user facing. It is unclear whether a consumer/user facing business is one for which all four characteristics must be present, or how each of these attributes would be defined. Among the questions that need to be addressed are: (1) Is a consumer/user facing business only one that has all four of the characteristics identified in paragraph 19 of the Consultation Document? (2) Which, if any, business-to-business transactions would be considered to be consumer/user facing? (3) What is the threshold for “significant” marketing and branding activity and how is it measured, e.g. amount of expenditures, expenditures as a percentage of sales, etc.?

If consumer/user facing businesses include those that do not sell to or directly interact with final consumers, it will be challenging for tax authorities and companies to determine the location of consumers and thus to determine where nexus exists and to allocate Amount A accurately.

In some cases, sellers only market to other businesses (e.g., brake pads that are sold predominantly to original equipment manufacturers and service providers). If the definition of “consumer/user facing” *excludes* companies that only market to other businesses, the need to have information about the location of ultimate consumers for purposes of nexus and allocation of Amount A would be reduced. In other cases, a company may sell the same product through retail distribution channels and as a component to manufacturers (e.g. car radios) and it will need to be clarified whether only sales of the first type are consumer facing.

Sellers of final products to unrelated distributors (e.g. a wholesaler that sells to retailers in more than one country) may not in the ordinary course of business receive information on the location of final customers. In such cases, guidance will be needed regarding acceptable methods for estimating the location of final consumers. In other cases, due to package language, warranty program, regulatory requirements, contractual arrangements with independent distributors, or other factors, a company that does not directly interact with consumers may nevertheless have reliable information on their location.

If the scope of consumer/user facing businesses is not clearly defined and limited to transactions where the seller can determine the location of the ultimate customer with reasonable accuracy, the “Unified Approach” will increase uncertainty, tax disputes, and distortions, creating the very tax “chaos” that the project is intended to avoid.

Question 1.b. Defining the MNE Group

Tax and financial consolidation principles differ. Financial statements generally consolidate investments in other companies where more than 50% of the stock is owned. By contrast, tax accounting generally allows consolidation only at a higher ownership threshold. In addition, financial accounting uses the equity method for minority-owned investments that are above a portfolio level of ownership, and the cost method for portfolio investments. By contrast, tax



accounting generally uses the cost method for both portfolio and other investments in non-consolidated legal entities.

If Amount A is determined by reference to income reported in consolidated financial statements, as is proposed in the Consultation Document, then consistency would seem to require the MNE group to be defined based on financial statement consolidation principles.

Question 1.c. Sales to Intermediaries

As discussed above in response to Question 1.a., the “Unified Approach” requires allocation of Amount A to the jurisdictions where consumers/users reside. Where a company sells to intermediaries, it may not have or receive information about the location of final customers in the ordinary course of its business. In situations where the seller does not know the location of final customers, requiring allocation of Amount A would increase uncertainty and disputes, contrary to the goals of Pillar 1.

Question 1.d. Size of the MNE Group

Given the additional costs of compliance and administration that will arise under the “Unified Approach”, a high threshold for the size of affected MNE groups would limit the burden on tax authorities and less-resourced businesses. A high percentage of sales and income can be captured by limiting the scope to a small number of very large companies. The analysis of large and very large companies in the EU(28), Japan, Korea, and the U.S. for the year 2017 shows that groups with global turnover above the €750m threshold represent 26% of the total sample and account for 93% of the total profit before tax (PBT) of the sample.¹ It should be considered whether multiple (or higher) thresholds would be appropriate to reduce this burden.

If the threshold is measured in terms of sales and there are scope limitations (e.g., consumer/user facing), a test against this threshold that is not restricted to sales within scope (which is a more appropriate metric than total sales) risks considerable compliance costs for little return. In addition, consideration should be given to periodic adjustment of monetary thresholds to account for inflation and prevent erosion of the threshold in ‘real terms’.

For the avoidance of doubt, it should be stated clearly that a business below the global threshold is out of scope entirely regardless of the level of sales in any individual country.

¹ The consolidated financial statements used for this analysis are downloaded from the dataset TP Catalyst produced by Bureau Van Dijk and include companies with annual turnover above US\$120m. We downloaded data for the years 2012-2018 for Australia, EU(28), Japan, Korea, Singapore and the United States. We have then dropped groups with an EBIT margin larger than 100% or smaller than -100%. Given the limited availability of variables such as EBIT, profit before tax, sales and turnover, Australia and Singapore display only one and three companies respectively in some years (e.g., in 2017). Australia and Singapore have therefore been dropped from the sample. Further information on the dataset and the analysis, including by individual European country is available upon request.



Question 1.e. Carve Outs

The sectors that should be carved out from the application of the “Unified Approach” are, as a matter of logic, the inverse of the sectors that are intended to be within scope. Thus, to have a coherent approach to carve outs it is essential that the underlying economic rationale for the “Unified Approach” – particularly Amount A – be clearly articulated.

As noted above, it appears the focus of Pillar 1 is highly digitalised business models and transactions where the ALP is not delivering the outcomes that countries consider appropriate in some cases. However, without further clarity about where the ALP is considered not to be delivering the desired outcomes (i.e. is it related to generation of high profit margins, or is it related to the deemed value of the market?), there is a less principled basis for establishing carve outs.

For companies with business lines that are both within and without the scope of the “Unified Approach,” the calculation and allocation of Amount A will require determining revenues and expenses at the business line level. In many cases it will not be possible to rely on existing tax or financial statement reporting to obtain the detailed segment information required to implement the “Unified Approach.” Even with detailed guidance provided under Pillar 1, companies may need considerable latitude to calculate segment information based on business judgment and data availability, and such latitude should be permitted so long as consistent and reasonable methods are used.

Question 2. New Nexus

Given that the proposed separate nexus rule represents a significant departure from current notions of the circumstances allowing for a taxing right to exist, the following comments are meant to illustrate the wide range of unresolved issues that should be considered with this element.

As a general and preliminary matter, we note that the existing international tax framework (generally) has both nexus and profit allocation standards based on physical activities of a business, and accordingly there is built-in coherency between the two. This has been critical for both tax administrations in administering the system, and for businesses in complying, because it has limited the compliance burden and tax impact to scenarios where there is likely to be a degree of profits attributable to make it worthwhile. It is imperative that whatever nexus standard is agreed is similarly linked to the expected allocation of profits (e.g. if the profits will be allocated to the location of customers, then a threshold based on number of users may be incoherent).



Question 2.a. Defining and applying country specific sales thresholds

While we recognise the importance of separate country revenue thresholds independent of a global threshold, we note that this will likely increase administrative and compliance costs for businesses. With increased access to markets through digitalisation, many businesses will have a market presence in multiple (i.e. in many cases 100 or more) jurisdictions, thus requiring them to monitor the thresholds for each jurisdiction, determine tax liability, file returns, and pay taxes, unless a centralized filing mechanism is adopted. Triggering taxation under Pillar 1 only where there is a substantial market presence in a given country could involve a number of factors.

Sustained Threshold

As articulated in the May Programme of Work, the goal of a new nexus test is to reach businesses that have a “significant and sustained involvement” in a marketplace. A monetary threshold addresses the “significant” part of the standard but does not address the “sustained” component, which implies an involvement that is maintained during an extended period of time (i.e. that is not momentary or transitory). Depending on the product or service, a monetary threshold could be exceeded with a relatively small number of transactions in a certain year, but that would not necessarily mean that the business has a sustained involvement (i.e. maintained at length) in a given jurisdiction. Thus, a business might be able to apply the significant threshold(s) discussed above taking into account either: (i) the preceding taxable year, or (ii) the average ratio for the preceding three taxable years. Giving taxpayers the option of using the prior three years will mitigate the impact of cyclical changes or losses in one or more years.

Application to Lines of Business

In many cases businesses may operate in-scope activities alongside other activities that would be out of scope if operated independently (due to low profit margins or, not being “consumer facing”, for example). Absent agreed rules on appropriate segmentation, this may have the impact of bringing too much or too little profits into account of Amount A.

Operating segment data as defined under major accounting standards (e.g. IFRS, US GAAP) provides assurance level data that is useful to investors but may not be comparable or appropriate for the purposes of Amount A in many cases.

Segmentation appears to be a necessary feature of Amount A, and one which is desirable to some taxpayers and to some countries. It is imperative that additional work is undertaken to ensure that the distortions that may arise at a consolidated group level are equitably addressed.



Groups that have a physical presence in a marketplace

Applying tax under Pillar 1 to groups that already have a physical presence in a market, such as through a branch or affiliate, goes further than the concern that market economies were not able to share in the exploitation of their marketplace when a group has no taxable presence under traditional standards, and would seek to extend this right to address a different concern that the profits attributable under the ALP are not sufficient to reflect the value of exploiting a market.

The Consultation Document partly justifies the possible application of tax under Pillar 1 in cases in which an enterprise already has a physical presence in a given market based on the need to police the ability of companies to “side-step” the new rules by creating a minimal physical presence.

If the concern being addressed is that market economies are not able to levy any tax where there is no physical presence, an alternative approach might be to allow taxpayers to exclude the application of tax under Pillar 1 in those jurisdictions in which they have either a PE or related distributor with minimal additional revenues from digital interactions subject to anti-abuse criteria. The anti-abuse criteria would require electing taxpayers to apply new standards to the profit allocation to marketing and distribution functions that already exist by virtue of a PE or an affiliated distributor, provided those functions are an integral part of the business activities and directly contribute to the generation of its revenue (perhaps attributing digital interaction with users there to that entity). As in the case of Amount C, the local taxing authority would have the ability to allocate greater profits to the PE/distributor based largely on traditional ALP. The exclusion would apply only where the local marketing/distribution activities report a return based on the return that would apply if the distributor were a customary unrelated distributor taking on full distribution and marketing activities and bearing risk. This would be consistent with the Consultation Document’s expressed intent that the new regime be compatible with, and not in substitution for, traditional principles, such as application of the ALP.

If the concern is rather that the ALP does not deliver a sufficient return for the exploitation of the market, then this increases considerably the compliance burden and the potential distortions (such as the incentive for companies to locate taxable activity in the market jurisdiction). It may be more administratively sensible in such a scenario to revisit the very concept of “Nexus” for Amount A purposes and develop a mechanism that delivers taxable income to all countries without the need for them to undertake different compliance exercises in countries where they have a physical presence to those where they do not.

Question 2.b. Calibration to ensure that jurisdictions with smaller economies can also benefit

It is envisaged in the Work Programme that a business receiving less than a certain minimum amount of local revenue from persons in the local jurisdiction should be out of scope. Rather



than having just a specific figure, such as €10 million or other amount determined by impact assessment, it could perhaps be a measure based on a country's GDP.

A monetary threshold addresses the “significant” part of the standard but does not seem to be, in and of itself, the only factor to be considered in measuring the significance of a business (either physical or digital) footprint in a particular marketplace. Thus, in testing whether a business presence is significant enough in a certain jurisdiction so as to be subject to taxation under Pillar 1, we suggest that the following additional criteria could be considered, before Pillar 1 thresholds are triggered:

- the number of consumers (e.g. a business with less than X consumers in the local jurisdiction should be out of scope); and
- the number of transactions (e.g., a business that concludes fewer than X business transactions with persons resident in the local jurisdiction should be out of scope).

Question 3. Calculating Amount A Group Profits

Question 3.a. Appropriate group profit metrics

For the identification of the appropriate metric for group profit, we consider two main issues: (a) the choice and trade-off between profit for tax purposes versus accounting profit, and (b) the choice of which profitability measure to use, once the first issue has been resolved.

Profit for tax purposes versus accounting profit

The choice between profit for tax purposes versus accounting profit is shaped by the trade-off between simplicity and verifiability, and the role of tax policy in affecting the post-tax profit margin. The debate on the wisdom and extent of alignment of taxable business profits and accounting profits is a longstanding one (Freedman, 2004, 2008²). Policy makers could refer to such a debate (Holmes, 2001; James, 2002, Desai, 2003; Spengel, 2003; Freedman, 2004, 2008, Shön, 2004; Alley and Simon, 2005; Gammie et al., 2005; Jacobs et al., 2005; Haverals, 2007; Oestreicher and Spengel, 2007; Lang et al., 2008; Eberhartinger and Klostermann, 2007; Shaviro, 2009; Gavana et al. 2015³) to assess the broad implications of using financial accounts

² Freedman, Judith, Aligning Taxable Profits and Accounting Profits: Accounting Standards, Legislators and Judges. eJournal of Tax Research, Vol. 2, No. 1. Available at SSRN: <https://ssrn.com/abstract=643991>; Freedman, Judith, Financial and Tax Accounting: Transparency and 'Truth'. TAX AND CORPORATE GOVERNANCE, Schön, ed., Springer Science, 2008 ; Oxford Legal Studies Research Paper No. 2/2008. Available at SSRN: <https://ssrn.com/abstract=1085862>.

³ Alley, C. and Simon, J. (2005) „The use of financial reporting standards-based accounting for the preparation of tax returns“, International Tax Journal, 31 (3), pp. 31-48.

Desai, M. (2003) „The Divergence between Book and Tax Income“, in J. Poterba (ed.), Tax Policy and the Economy 17 (Cambridge, MA: MIT Press, 2003), pp.169-206.

Eberhartinger, E. and Klostermann, M. (2007), What if IFRS were a Tax Base? New Empirical Evidence from an Austrian

for tax purposes and go beyond the consideration of important but very specific questions on how the accounts can be practically used for assessing the tax liability under Amount A.

Some argue that audited financial statements provide for simplicity and verifiability of profit and their use could also cut compliance costs. However, commercial accounts and tax accounts have different objectives. Commercial accounts primarily reflect the ability of a company to generate cash flows so that investors can make forward-looking economic decisions. Tax accounts take an historical perspective and are concerned with the profits and losses in a period and account for the taxpayer's ability to pay (Freedman, 2004, 2008). With some exceptions, tax accounting is generally based on historical cost measurement while financial accounting is based on fair value accounting (Blaufus and Jacob, 2017)⁴.

The divergence in objectives between the two types of books creates drawbacks in relying on accounting profit for tax matters. For example, tax payments could become more counter-cyclical and corporations might have to pay taxes on unrealized gains (Keen et al., 2010⁵; Blaufus and Jacob, 2017). In addition, relying on accounting standards carries some risks for the effectiveness of governments' tax policy choices. In contrast to the rules defining the tax base, accounting standards are set by an unelected body, the International Accounting Standards Board (IASB) and not by the national (or international) tax policy makers to reflect the positions

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⁴ Blaufus, Kay and Jacob, Martin, Tax Related Implications of Fair Value Accounting (September 14, 2017). Forthcoming in: The Routledge Companion to Fair Value in Accounting and Reporting, Edited by: Livne, Gilad and Garen Markarian. London: Routledge. Available at SSRN: <https://ssrn.com/abstract=3036857> or <http://dx.doi.org/10.2139/ssrn.3036857>.

⁵ Keen, M., Klemm, A., & Perry, V. (2010). Culpit, Accomplice, or Bystander? Tax Policy and the Shaping of the Crisis. In: Taxation and the financial crisis (Editors: J. Alworth & G. Arachi). European Tax Policy Form/Institute for Fiscal Studies Conference.



and views of a government (or various governments) or legislature. In relying on financial accounts, governments could end up ceding part of their ability to use tax policy as an instrument to manage their economy; this might result in partially handing over control of their tax base to the IASB (Freedman, 2004, 2008). For these reasons, the application of an Amount A based on accounting standards should arguably be modest and limited to a small number of entities.

The Consultation Document seems to suggest that taxable income is an overlay on Amount A, given that Amount A is not intended to erode the allocation of routine activities. Even within the limitations of taxable income, accounting standards will determine Amount A in the new system and, very importantly (depending on the final details), they will also determine the scope of the new measures (possibly in reconciliation with taxable income). The larger Amount A is, the larger the risks of counter-cyclicalities, of tax payments being based on unrealised gains, and of transferring the control of the tax base from national governments. Nonetheless, even with a modest calculated amount, the accounting rules determining Amount A establish the scope of the new measures by governing the level of profitability at which the new system is applicable. For this reason, it is important that the chosen accounting profitability measures are as close as possible to taxpayers' real ability to pay which, among other factors, would at least partially reflect governments' tax policy (see next section on profitability). There is also the choice of which accounting standards to use. This seems relatively straightforward if consolidated accounts are used.

If Amount A is determined by reference to income reported in consolidated financial statements, consistency would require the MNE group be defined based on financial statement consolidation principles. Many state that the advantages of using audited consolidated reports is that accounts are readily available without imposing an additional administrative burden upon the MNE. Further, it would allow calculating Amount A on a centralized basis for then allocating it to the different markets. Nonetheless, the reality is that for only a few multinational groups do the financial statements contain information by market. Certain issues, however, may arise. For example, in case the MNE consolidates at a level below the ultimate parent, then such consolidation at a lower level may be used (i.e. at a regional level). A more difficult situation exists where consolidated accounts are required at business line level (see question 3.c).

There are also additional issues to consider, such as the accounting choice for companies that are not covered in the consolidated accounts, or for private companies. Consolidated MNE entities may differ from the entities that are part of the MNE group as such. As Amount A is only a deemed amount based on deemed residual profits of the group, the fact that the consolidation group and the MNE group does not fully coincide could be considered an issue from a pragmatic and practical point of view. For private companies that meet the threshold for Amount A, a deemed consolidation based upon the consolidation rules of the ultimate parent entity (UPE) may be considered (e.g. the deemed consolidation could be based upon statutory accounts of the different entities). If different approaches were applied for an MNE with the UPE situated in the



same jurisdiction (i.e. one MNE using consolidation and another not using consolidation) using different standards would lead to discrimination.

Profitability measures

The choice of a profitability measure implies a choice on both the numerator (profit) and the denominator (sales/revenue). With regard to the numerator, one could use gross profit, EBITDA, EBIT/operating profit, or profit (loss) before tax (PBT). For the denominator, there is the choice between sales (net or gross) or revenue (where the revenue comprehensively encompasses all revenue elements, including those not strictly related to sales). Table 1 below represents a simplified profit and loss (P&L) account and the relationship between the various measures of profit and sales.

Advantages and disadvantages of using each measure mentioned above determine a trade-off. A profitability measure that is down the P&L account would better reflect the real cost of doing business and for the taxpayer's ability to pay, a necessary principle for the functioning of the tax system.

For example, PBT includes all the interest that the company should pay, the depreciation of assets, and other expenses. Without accounting for investment expenditure and its financing, the new corporate tax system will dampen investment and therefore growth (see Hall and Jorgenson, 1967; Hayashi, 1982; and Summers, 1981, Auerbach and Hassett, 1992, Cummins, Hassett and Hubbard, 1994, Chirinko, Fazzari and Meyer, 1999, Desai and Goolsbee, 2004, Feldstein, 2006, House and Shapiro, 2008, Bond and Xing, 2015, Ohn, 2015).⁶ Should policymakers' goal be a cash flow tax that is not distortive of investment decisions rather than an income tax, then it would make sense to not deduct interest expense but allow full expensing on investment. Worries that PBT would be lowered by the excessive use of debt financing are addressed by BEPS Action 4 and Pillar 2. Such worries should not push the tax system towards rules that do not account for investment expenditure and financing and hence, for the taxpayer's real ability to pay. A system that imposes the same tax liability on firms that invest and don't invest will incentivise corporations to hold up investment.

⁶ Auerbach, A. J., and Hassett, K.J., "Tax policy and business fixed investment in the United States." *Journal of Public Economics*, 47(2): 141-170, 1992. Bond, S., and Xing, J., "Corporate taxation and capital accumulation: Evidence from sectoral panel data for 14 OECD countries", *Journal of Public Economics*, 130: 15-31, 2015. Chirinko, R.S., Fazzari, S.M., and Meyer, A.P., "How responsive is business capital formation to its user cost? An exploration with micro data", *Journal of Public Economics*, 74(1): 53-80, 1999. Cummins, J.G., Hassett, K.A., Hubbard, G.R., "A reconsideration of investment behavior using tax reforms as natural experiments", *Brookings Papers on Economic Activity*, 2: 1-74, 1994. Desai, M. A., and Goolsbee, A.D., "Investment, overhang, and tax policy.", *Brookings Papers on Economic Activity*, 35(2): 285-355, 2004. Hall, R.E., and Jorgenson, D. W., "Tax Policy and Investment Behavior." *American Economic Review*, 57(3): 391-414, 1967. House, C., and Shapiro, M., "Temporary Investment Tax Incentives: Theory with Evidence from Bonus Depreciation." *American Economic Review*, 98(3): 737-68, 2008. Hayashi, F., "Tobin's Marginal q and Average q: A Neoclassical Interpretation." *Econometrica*, 50(1): 213-224, 1982. Feldstein M., "Europe has to face the threat of America's trade deficit", *The Financial Times*, 2 August, 2006. Ohn, E., "The Effect of Corporate Taxation on Investment and Financial Policy: Evidence from the DPAD", *American Economic Journal: Economic Policy*, 10, issue 2, p. 272-301, 2018. Summers, L. H., "Taxation and Corporate Investment: A q-Theory Approach." *Brookings Papers on Economic Activity*, 1981(1): 67-140, 1981.



Table 2 (Panel A) shows that using accounting figures such as gross profit or EBITDA to calculate Amount A could artificially inflate the profitability of a group while disregarding the taxpayer's ability to pay. For example, let's assume a 10% profitability benchmark for Amount A. If 10% refers to gross profit or EBITDA, the company represented in Table 2 (Panel A) will be liable under Amount A, even if its PBT is negative. In other words, gross profit and EBITDA disregard the investment (and its financing) done by the firm and, consequently, its ability to pay. In addition, Table 2 shows that if gross profit and EBITDA are used as benchmark profitability measures, a corporate group that invests (Panel A) will be liable to the same amount of A as a group that invests much less (Panel B) and hence, has a higher ability to pay.

The further down the P&L account the profitability measure is, the less homogeneous the result will be across jurisdictions and accounting standards. Nonetheless, many of the differences may be timing in nature and they could be dealt with by taking an averaging approach to PBT over a number of years.

There are also some additional issues to consider. For example, are different profitability measures suitable to different sectors (e.g., capital intensive businesses)? There may also be some qualifying private or private equity groups that may not have available consolidated financial statements and should thus be taken into account in how technical rules are developed.

Table 1. Simplified P&L account.

	Column A	Column B
	Corporate group with large investment	Corporate group with little investment
Revenue	1,600,000	1,600,000
Gross Sales	1,400,000	1,400,000
Returns, allowances, and discounts	140,000	140,000
Net sales	1,260,000	1,260,000
Cost of goods sold	1,100,000	1,100,000
Gross profit	360,000	360,000
Operating expenses	200,000	200,000
Earnings before interest, tax, depreciation and amortisation (EBITDA)	160,000	160,000
Depreciation and amortisation	140,000	20,000



Earning before interest and tax (EBIT)/Operating income	20,000	140,000
Interest expense	30,000	0
Profit before tax (PBT)	-10,000	140,000
Income tax expense	0	28,000
Net income	-10,000	112,000

Table 2. Simplified P&L account.

<i>Panel A - Corporate group with large investment</i>			
	<i>Denominator</i>		
Numerator	Revenue	Gross sales	Net sales
Gross profit	22.50%	25.71%	28.57%
EBITDA	10.00%	11.43%	12.70%
EBIT	1.25%	1.43%	1.59%
PBT	-0.63%	-0.71%	-0.79%
<i>Panel B - Corporate group with little investment</i>			
	<i>Denominator</i>		
Numerator	Revenue	Gross sales	Net sales
Gross profit	22.50%	25.71%	28.57%
EBITDA	10.00%	11.43%	12.70%
EBIT	8.75%	10.00%	11.11%
PBT	8.75%	10.00%	11.11%

Question 3.b. Standardised adjustments

The basic trade-off faced when contemplating adjustments is between reducing complexity and keeping the tax system in line with desired tax policy.

Conscious that the introduction of many adjustments could lead to increased complexity and a higher compliance burden, a partial list of possible adjustments to be aware of include:



- depreciation for investment deductions;
- timing adjustments;
- profits and losses that are never recognised in local GAAP or tax (e.g. when a business is acquired through a share acquisition, the assets and liabilities are at fair value; the fair value and subsequent depreciation/amortisation will in many cases never be reflected in tax returns and should therefore be removed from the calculations of Amount A);
- fair value accounting (e.g. for derivatives in group profits);
- disposals and discontinued operations;
- consolidation adjustments;
- lease accounting;
- foreign exchange (e.g. hedging, translation, etc.); and
- consolidation group definition (e.g. control) for dealing with PE/ branches/ associates/ joint ventures

Question 3.c. Segmentation

Segmentation could be used to introduce a closer link between the tax system and the economic reality of various multinational groups engaged in different activities characterised by different profit margins. Segmentation would also prevent more profitable business lines and markets from subsidising low profitability business lines and markets.

In reality, however, segmentation presents important challenges and may not fit all multinational groups in the same way. Segmentation within financial accounts is determined by how the local management run and operate their business across different business lines and different geographical areas. In addition, for companies with products and services sold to both the final consumer and other businesses (e.g. washing machines sold to private households but also to hotels), business lines are not run and operated based on whether they are “consumer facing” or not. Hence, differentiating global businesses profits would require significant extra work and data. For the same reason, it is difficult to understand how segmentation can be harmonised across different multinational groups which are run and operated differently by their management.

As soon as the system moves away from segmentation in published consolidated financial statements, the benefits of using audited consolidated financial statements may be lost. Finally, it will be challenging for the tax authority to identify, define, and police business lines definitions. This could create a great amount of uncertainty which could be partially reduced if one jurisdiction - presumably the parent company jurisdiction - is in control of the Amount A determination and allocation.

There are potential solutions to these highlighted problems. To solve complexity and decrease the compliance burden, multinational groups might be allowed electivity regarding segmentation. In addition, to avoid the complexities involved in segmenting between “consumer



facing” and non-consumer facing, where a business has met a “revenue” threshold, it can either use the total segment with the consumer facing business within or undertake the work to break it down further.

Question 4. Determining Amount A

The current proposal in the “Unified Approach” does not seem to articulate any general, theoretical principles that underlie the determination of the quantum of Amount A. Therefore, reliance on data and in particular on the distribution of profitability in the economy seem to be the only guidance we have.

Table 3 shows the distribution of the EBIT margin for the United States, European countries (EU(28)) and Asia.⁷ The median (P50) EBIT margin differs across regions, varying between 6.47% in the U.S. and 4.39% in the EU(28). These values for the median imply that with a benchmark profitability for Amount A that is low (e.g. between 5% and 7%), about half the population of firms in all regions will be subject to the new rules. This implies a large shift in the system towards destination and new rules and compliance obligations for a very large number of corporate groups globally. Given the variability of profitability across regions, if a 10% profitability benchmark were to be used, well more than 25% of the US population would fall in scope compared to about 25% of the EU and Asia population.

Table 3. Distribution of EBIT margin by region (2017) - %.

Year	Min	P1	P5	P10	P25	Median (p50)	Mean	P75	P90	P95	P99	Max	SD	Total number of corporate groups
US EBIT margin - Total Sample														
2017	-100	-90.64	-52.94	-29.82	-3.24	6.47	5.47	17.39	36.56	58.92	85.53	100	30.18	3,584
EU EBIT margin - Total Sample														
2017	-99.55	-54.72	-11.51	-2.11	1.37	4.39	5.49	9.42	17.42	25.91	58.1	100	15.66	7,419
ASIA EBIT margin - Total Sample														
2017	-97.85	-39.42	-8.75	-1.34	1.9	4.92	5.22	9.08	15.33	20.24	36.66	99.29	11.66	4,198

Table 4. Distribution of EBIT margin by sector (US - 2017) - %.

	Min	p1	p5	p10	p25	Median (p50)	Mean	p75	p90	p95	p99	Max	SD	N
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⁷ We analyse EBIT margin because EBIT is more widely available than PBT in our dataset.

Agriculture Forestry and Fishing	-	-	-	-	-	5.6	5.69	25.2	45.3	48.7	48.7	48.8	27.6	17
Construction	-46.4	-46.4	37.2	-10.4	2.73	5.9	3.77	8.94	13.1	27.2	34.8	34.8	13.9	58
Finance Insurance and Real Estate	-100	-93.4	58.4	-35.9	0	23.6	22.71	53.8	78.6	85.3	95.9	100	42.3	657
Manufacturing	-99.8	-93.4	56.1	-27.9	-2.8	6	1.13	12.9	20.9	28.8	50.6	98.5	24.7	1,250
Mining	-94.9	-91.5	50.3	29.9	-8.5	6.6	6.67	20.2	47	67.1	90.8	98.1	32.5	195
Services	-99.3	-90.3	58.8	40.4	12.7	3.1	-2.35	12.9	24	32.4	54.8	85.5	26.5	739
Trade	-93.9	-73.7	34.1	14.17	0.31	3.5	1.16	8.5	14.5	19.5	34.9	65.8	17.9	346
Transportation, Communications, Electric, Gas and Sanitary Service	-94.9	-73.5	39.4	-15.2	2.21	11.8	9.26	21.3	30.6	38.9	60.9	70.7	23.2	322
Total	-100	-90.6	52.9	29.9	3.24	6.5	5.47	17.4	36.6	58.9	85.5	100	30.2	3,584

Figure 1. Average EBIT margin (2012-2018).

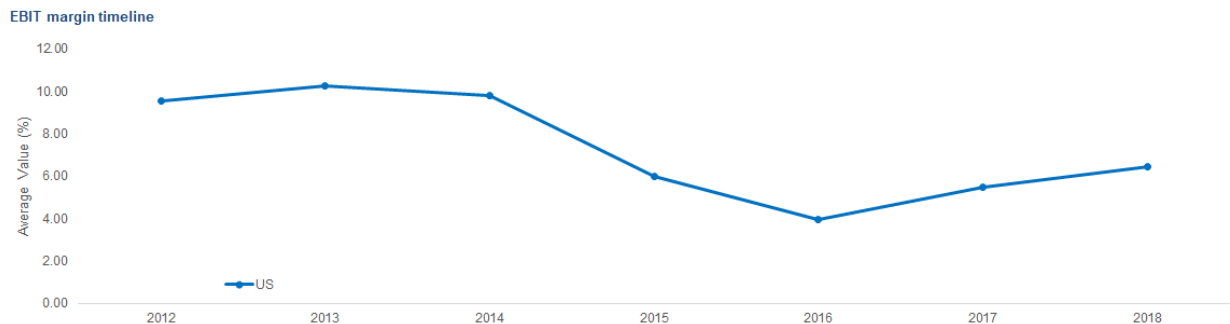


Table 4 shows the distribution of the EBIT margin for 8 different sectors (2017)⁸ and indicates a large variation ranging between 3.1% for Services and around 24% for Finance, Insurance and Real Estate. For the same sample, Figure 1 shows the variability of the EBIT margin across time.

In summary, there is large profitability variation across geographical regions, sectors, and time. Such variation shows that a one-size-fits-all measure for profitability could introduce distortions in the tax system. To avoid distortions, the calculation for Amount A may need to reflect the

⁸ For brevity we present only US data but the same information is available upon request for European countries (EU(28)) and Asia.



variability. Time variation should be accommodated with averages taken across a certain amount of years.

Given that the underlying principles of the proposed formula for the calculation of Amount A are unclear, the incentives for market countries will be to subsequently and frequently ask for changes to the figures in the formula through later negotiations. Hence, an important part of the determination of Amount A is the design of a mechanism for the formula to be stable, at least for some years, unless governments aim to move an increasing amount of corporate tax revenues to the markets. It remains to be seen whether agreement on the parameters in the formula underlying Amount A comprise a set time for the duration of the accord.

If no guidance is given on how the parameters for Amount A will be determined, the OECD Secretariat has set forth some practical guiding points for the more general determination of Amount A by proposing that:

1. Amount A should be limited to "consumer facing" businesses, and
2. The allocation should be made based on the location of the final customer.

This raises a number of difficult issues. For example, it will be necessary to determine which sales relate to "consumer facing" businesses. This exercise will be challenging without a clear definition of what a "consumer facing" business is, especially if the definition moves away from better known (although not entirely precise) concepts such as business to consumer (B2C) and business to business (B2B), towards much harder concepts to define and measure, such as marketing activities directed at consumers, interaction with consumers/users, etc.

As is well known to VAT experts, the determination of destination is challenging: who is the final customer and where is he/she/it located? The first question boils down to how many layers the system will look through to assess who the final customer is. For example, if a scarf is sold through a third party reseller first from France to Spain and then to Morocco, will the new system look through the three transactions and get to the Moroccan final consumer? In other words, is the new system intended to be applied throughout the supply chain (at every stage like a VAT – so multi-stage) or is it intended to be applied single-stage (to the end user at the final point of sale - like a retail sales tax)? If the system is intended to be applied at the final point of sale (i.e., beyond the French-Spanish transaction), companies will need to track where their goods are being sold if they change hands multiple times following the sale. If Pillar 1 were to also distinguish between sales to consumers and sales to businesses, at the moment, data at such a detailed level is not available in most cases. In addition, challenges exist if unaudited figures are used for the sales allocation key.

Recognising the difficulty of practically determining destination in the real world, the VAT has tackled the issue by determining the place of consumption based on the destination principle through the use of proxies as determining actual consumption is not deemed possible (see also



the OECD International VAT/GST Guidelines). For the application of the destination principle in VAT based on proxies and for determining the VAT collection regime, the following aspects need to be considered in addition:

1. Definition of the customer: Business (B) vs Consumer (C);
2. Determining the customer status (B vs C) and evidence required for that.

Also when it comes to VAT collection the OECD International VAT/GST Guidelines provide solutions such as the simplified VAT registration regime for foreign vendors supplying B2C digital services cross-border or in the B2B context the application of the reverse charge regime. The Guidelines and the report on “*Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located In the Jurisdiction of Taxation*” recognise that when dealing with remote vendors, simplified registration and compliance regimes are critical to the effective and efficient collection of VAT/GST.

Such mechanisms have been put in place after careful study of the practical and theoretical challenges of taxing in the market. The question is whether practically determining the destination for Amount A is possible in a way that is different from what has already been studied and assessed for VAT purposes.

Many of the issues discussed in this section and in the preceding section could have a limited impact if the benchmark profitability threshold is set at an appropriate level. Data shows that a high percentage of income can be captured by limiting the scope to a smaller number of companies (see Table 5).

Table 5. Share of total profit covered by each benchmark profitability threshold

	Profitability threshold		
	EBIT > 10%	EBIT > 15%	EBIT > 20%
EU(28)	59%	38%	23%
Japan	39%	23%	13%
Korea	58%	51%	44%



US	82%	64%	51%
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Question 5. Eliminating double taxation in Amount A

The Secretariat’s proposed “Unified Approach” would layer profit allocation formulas on top of the existing ALP for allocating profits, mechanically creating a risk of double taxation. The potential for double taxation has many possible sources: the potential overlap of two or more market jurisdictions taxing the same income; the potential overlap of one or more residence jurisdictions taxing the same income that is allocated to market jurisdictions; a disconnect between who is seen as the taxpayer for the tax under Pillar 1 and who is the taxpayer under domestic laws; the possibility of different tax bases, depending on how the tax under Pillar 1 is calculated; potential timing differences; and differing treatment of loss carryovers and carrybacks. The potential risk is heightened because the proposal would allow market countries to impose tax on a multinational business without necessarily tying that tax to a particular taxpaying entity within the multinational group.

To prevent the new Amount A taxation rights from creating double taxation of the same income, therefore, it will be necessary to establish: (1) complex sourcing rules; (2) a mechanism for identifying which entity or entities within the multinational group will be liable for the taxes imposed by market countries; and (3) a mechanism for fully relieving the double taxation of each taxpaying entity (e.g. correlative adjustments)⁹.

There is no existing mechanism in the domestic laws of many states to implement and coordinate such income adjustments among market and surrender states. Moreover, even if domestic laws could be modified to recognize such income adjustments among market and surrender states, many difficult questions would need to be resolved.

Question 5.a Identifying relevant taxpayer(s) entitled to relief

One of the primary questions would involve determining the identity of the so-called surrender state, which apparently would be determined consistently with the principle applied to allocate some amount of otherwise arm’s length profits away from it in favour of a market state(s). If such allocation is based on giving a market state a new taxing right over, for example, a portion of the MNE group’s “deemed residual profit,” then the surrender state(s) would apparently be

⁹ Interaction with Pillar 2 (particularly in relation to accounting implications) must be considered.



the state(s) which would have earned such residual profit under a traditional application of the ALP.

A key policy question is where it is intended for Amount A to be taken from. It is unclear whether (absent Amount A reallocations), Amounts B and C are intended to represent all taxable profits, or whether additional (residual) profits are expected to be recognised elsewhere. This would lead to different outcomes being appropriate.

It is not difficult to envision disputes regarding the identity of the surrender state(s), or the amount of income adjustments deemed to flow to market states, and the identity of such market states. In order to prevent widespread double taxation, however, it would be necessary to ensure precise correspondence of the amount of such downward income adjustments in surrender states and upward income adjustments in market states, as well as the identity of those states.

Question 5.b. Building on existing mechanisms of double tax relief

To prevent widespread double taxation, it is essential that additional work be undertaken to ensure that income allocations are coordinated among market states and surrender states. Deemed taxpaying countries (surrender states) should be required to relieve double tax through correlative adjustments (or other mechanisms that wholly relieve double taxation). Countries relieving double tax through a credit mechanism would need to ensure, through either domestic law changes or treaties, that the market country tax allocated to a taxpayer in the country is eligible for credit.

Similarly, countries relieving double tax through an exemption mechanism would need to ensure, through either domestic law changes or treaties, that a taxpayer in the country can reduce its local taxable income by the amount of income assigned to market countries, to the extent allocated to that taxpayer. A critical part of this work will be reaching consensus on the principle for determining what entities within the group should be treated as the "surrender" entities under the new regime for this purpose (for purposes of determining the correlative adjustments or who is entitled to claim credits or exemptions and in what amounts or proportions).

Assuming the amount to be allocated to market countries is based on the amount of consolidated financial statement income above some threshold margin, in principle all entities within the consolidated financial reporting group with separate financial statement income above the threshold margin should be treated as a surrender entity. Identifying surrender entities based on financial statement income would avoid a complicated facts and circumstances standard, like a DEMPE standard, or other transfer pricing-type standard that would be contrary to the goal of providing a formulaic income allocation to market countries and might create more controversies. That standard could be applied to potential surrender entities on a segment basis if the market country tax is determined on a segment basis. Then, the amount of deemed income



of each market country could be allocated away from each surrender entity (for tax credit or exemption purposes) on a pro-rata basis, in proportion to each surrender entity's relative excess income.

For some MNE groups with a more decentralized structure where the residual is spread across different jurisdictions, this approach could entail allocating income among perhaps dozens of surrender states and/or numerous (e.g., 100 or more) market states. Such allocations may be exceedingly complex to implement and would compound the potential for double taxation (e.g. if all such states do not apply the allocation formula in precisely the same manner). Therefore, to promote administrative simplicity and lessen the potential for double taxation, the MNE group's ultimate parent company should be permitted to make an election under which the parent assumes responsibility for all of the income allocated to market states.

Question 5.c. Ensuring that existing mechanisms for eliminating double taxation continue to operate effectively and as intended

The taxpaying entity's local jurisdiction (a "surrender state") will need to recognise the portion of the taxpaying entity's income allocated to a market state above and beyond the amount allocated to the market state under the ALP, and correspondingly accept an allocation of less than an arm's length amount of the taxpaying entity's income. Care will need to be taken to preserve existing exemption and credit mechanisms, either by sensitively adjusting them for the new allocations/credits or by introducing simultaneous provisions that apply concurrently.

Question 6. Amount B

The approach under Amount B seems to combine elements of the marketing intangibles approach under the February 2019 Consultation Document and the distribution-based approach outlined in the May Programme of Work, together with the suggested allocation rules with Amount C. Amount B only seems to be used in the context of routine or baseline marketing and distribution activities; other activities, such as R&D, manufacturing, intra-group financial services, etc., are not covered by a fixed ratio approach. This would mean that for activities other than marketing and distribution, the current transfer pricing approaches within the ALP would remain valid and would not fall under the aim of simplicity and increased certainty of the "Unified Approach". Nevertheless, we believe that for the other activities not covered under Amount B, dispute prevention and resolution mechanisms should be enhanced.

The Secretariat's proposal appears to allow jurisdictions to go beyond the baseline or routine level of functionality leading to a return in excess of the fixed Amount B return. An issue to be addressed is whether in all cases a two-step approach (Amount B and Amount C) need to be taken, or whether it suffices to address the issue under Amount C only.



Question 6.a Definition of qualifying activities

As an initial matter, a clear definition of the qualifying marketing and distribution activities that Amount B covers is required. Marketing and distribution activities encompass a broad array of steps pursued by a company.¹⁰ The importance of marketing may be shown on an MNE's balance sheet and P&L, particularly in R&D-intensive sectors. According to Copenhagen Economics¹¹, marketing intangibles make-up on average 40% of enterprise value in high R&D intensive sectors. In less R&D intensive sectors, this is reduced to an average of 27-32%.¹²

Generally, routine or baseline activities can be tested against activities performed under open market conditions and are typically transactions of a less complex nature that can be benchmarked using comparables. Although such routine or baseline activities could in principle fall under the normal transfer pricing rules, we understand that the goal of the "Unified Approach" is to simplify the arm's length evaluation by instead using a fixed or standardized return.

In short, a qualifying entity under Amount B would likely:

- Have a rather limited functions and risk profile;
- Not determine marketing strategies (which are determined by the manufacturer, principal, parent company or entrepreneur; the low risk entity merely executes the strategy imposed);
- Incur only non-significant expenses in relation to advertising, marketing and promotion expenses (absence of DEMPE functions related to marketing intangibles which remain with the principal or entrepreneur);
- Not own or control valuable long term supply agreements or materially manage and control key customer relationships relevant for the generation of sales in the local market jurisdiction;
- Not incur start-up costs (or very unlikely to); and
- Receive a modest but steady return guaranteed by the manufacturer, principal, parent company or entrepreneur.

¹⁰ Some of the most important components of marketing are: marketing research, advertising, pricing, customer support, media planning, public relations, sales, and brand promotion. A go-to-market strategy, which in most cases is tailored to address specific needs and wants, encompasses a myriad of activities or measures such as direct and indirect advertising, mailings (regular and electronic), telemarketing, presence at events and trade fairs, distribution of brochures and customer/consumer magazines or newsletters, use of e-tools like websites or social media, use of billboards, and press releases. Marketing activities can be performed at the global, regional or local level, or a combination thereof. Distribution is a step in the economic process whereby goods are delivered, or services are rendered to the customer or user. This step may consist of some of the following activities: handling purchasing orders (reception, processing); warehousing; transport; invoicing and invoice collection; customer account services; and after-sales services (for example complaints handling, product warranties and product returns).

¹¹ See: https://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/4/474/1550496379/future-taxation-of-company-profits_15022019_finalreport.pdf.

¹² Ibid. p 11-19



The description of routine or baseline marketing and distribution activities that qualify for Amount B can be based possibly upon the guidance developed for the sample Memorandum of Understanding on low-risk distribution services.¹³ Alternatively, should the IF want to increase the functionality and risk taking of the enterprises in scope of Amount B, reference could be made to the functionality and risk profile of a typical third-party distributor taking on common distributor functions the Amount B is seeking to approximate.

It is critical that the Amount B does not reflect remuneration of the DEMPE functions in relation to marketing intangibles or other economic rent generating activities which will be captured under Amount C. (See also our response to Question 2).

It may not be possible to delineate with precision routine or baseline marketing and distribution activities in an exhaustive list because of the divergences in how different MNEs are organized and the myriad of potential approaches and structures (and deemed related returns).

One possibility, however, is to determine what activities as a minimum would qualify as marketing and distribution functions. In the case of traditional transfer pricing and the accurate delineation of the transaction, this minimum activity would be labelled as a relative low risk marketing and distribution entity. Such a low risk marketing and distribution entity buys and sells the goods, or renders the services, in its own name and for its own account for another company (usually called the principal or the entrepreneur), under an arrangement where the latter assumes most risks. The marketing and distribution entity takes on full title basis ownership of the goods. High risk and high functionality marketing and distribution activities would fall under Amount C.

Question 6.b Determining the return under Amount B

PwC assumes on the basis of the Consultation Document that Amount B is a minimum fixed return(s) with the possibility for both tax authorities and taxpayers to “top up” this minimum return when the functionality of the marketing and distribution activities (effectively performed) go beyond the baseline or routine activity and thus warrants an additional return for those excess activities or if other activities are performed in the market jurisdiction. We have performed a high level limited analysis based on the elements described in the “Unified Approach”. When more details become available on the “Unified Approach” and on Amount B in particular, the analysis could be both expanded and refined. PwC has based its approach on EBIT/operating profit with sales as a profit level indicator.

¹³ See 2017 OECD Transfer Pricing Guidelines - Annex I to Chapter IV - Sample Memoranda of Understanding for Competent Authorities to Establish Bilateral Safe Harbours - p 465-469.



Fixed percentage

Some commentators indicate that it might be difficult to arrive at a one-size-fits-all approach.¹⁴ One possibility, however, is to determine the return that a low risk, low function marketing and distribution enterprises would require (possibly including variabilities per industry and region).

At least one country¹⁵ uses a safe harbour approach for marketing and distribution activities:

- marketing activities: mark up on total costs of 10-12% for marketing activities, excluding sales activities;
- low risk distribution activity: 3-4% operating margin.

Open questions that should be addressed include:

- Is a fixed percentage suitable for all businesses and regions?
- What are the linkages with ALP?
- What methodology to apply for determining the fixed percentage?
- Periodic review of fixed percentage.

PwC has performed a high level limited analysis based on global approach and a regional approach, as reflected in Appendix A.

The quantum of the fixed percentages is also key from the policy perspective. A percentage that is too high with respect to the median profitability in the economy would represent a very large shift of the international corporate tax system towards destination. A fixed return of about 3% return on sales (ROS) and a median EBIT margin of 4.65% in Asia and 4.23% in the EU(28) respectively (see Table 3) imply that about half of the companies in those two regions will see all or a large part of their income reallocated to markets. For example, for a group with an EBIT margin of 3%, all the income will be reallocated to markets under a fixed return approach of 3% ROS. For a company with 4.65% EBIT margin, 65% of its global income will be reallocated to markets. For the U.S., a fixed return of about 3% ROS and a median EBIT margin of 7.26% imply that half of the companies in the distribution will see slightly less of half of their income reallocated to markets.

Should IF countries want to limit the allocation of income to markets, fixed returns could be capped (e.g., no more than an x% of income should be allocated to the markets under Amount B) or linked to the global profitability of the group with lower fixed returns for lower profitability groups.

¹⁴ See footnote 11, Copenhagen Economics, p 16.

¹⁵ Israel - see also OECD Country Profiles.

Ranges

The use of ranges in the determination of the return covered by Amount B may perhaps lead to more complexity and less certainty as disputes may arise over which point in the range may be suitable. This situation may occur when countries or taxpayers are left free to select the point in the range which they deem most suitable.

In case the range is used simply as a tool to indicate that the Amount B return for the distribution entity is approximating what an independent distributor taking on common functions (including some risk) would earn, then the range can be used as a simplification mechanism. When the enterprise indicates that it falls within the set range, no adjustment is needed. The use of ranges offers flexibility to adapt the profitability under Amount B to be more in line with the economic reality of the taxpayers concerned. In particular, when regional and industry ranges are combined, tax administrations could publish a matrix of acceptable results, offering certainty when the matrix is used. Such matrix could be the object of a periodic review endorsed by the OECD and other regional tax organisations. Tax Administrations would need to work together to determine and review/update the matrix, in collaboration with external stakeholders.

Approaches other than returns linked to sales

Approaches other than a sales-based return could be appropriate. For example, the return could be based on the investment an enterprise or group has to perform in order to access the market. A relationship exists between an enterprise's investment in a certain market and the consumers in that market. This does not, however, mean that such investments automatically give rise to economic rents; in a highly competitive market, the profit margins and hence the return on investment will also be relatively low. Nevertheless, using investment as a profit indicator, possibly corrected with country specific information such as GDP, could be positioned as a valid alternative. This approach could be described as an alternative franchise model.

Franchising is based on a relationship between the brand owner and the local operator to skilfully and successfully extend one's established business system. The franchisor supports the operations of franchisees, develops and monitors the business systems, products and/or services through assisting various activities from marketing to finance. The role of the franchisee or partners can be described as possessing extensive and comprehensive local information and knowledge, such as local customers' preferences and national regulations. The franchisor's investment to get access to the market could be used as a key to allocate income.

The MNE decides whether local country presences are limited risk entities or co-entrepreneurs. When the entrepreneurial risk resides with, for example the headquarters or entrepreneur, the local entity would serve as a limited risk franchisee. They would be remunerated under an



operating profit approach with ROCE as a profit level indicator. The advantages of this alternative are:

- investment driven, with a link to country-specific investment;
- suitable for both “tech” and traditional business (or a combination thereof);
- based on enterprise data (and therefore no one-size fits all);
- fair and efficient and leads to market state taxation based on immobile factors;
- mirrors ALP, but recognizes value and revenue to the market;
- potential use of objective macro-economic parameters such as GDP per capita as a proxy for a country’s spending capacity.

On the other hand, measuring the ROCE might be challenging, but it would not be more difficult than measuring other profit level indicators.

As another alternative, the investment of a multinational group in customer acquisition and retention could be used as a key to allocate income to that market. The advantages are similar to the ones listed under the franchising approach mentioned above. Potential challenges to this approach include difficulty in measuring the customer acquisition cost, the fact-intensive nature of the assessment, it may not be suitable to all industries, and it offers no solution for highly regulated industries.

Challenges and opportunities of a fixed margin(s) approach

When appropriately determined, the use of fixed margins could reduce the burden for both taxpayers and tax authorities by causing:

- No necessity to determine a market return for the qualifying activities;
- Return acceptable for both taxpayers and stakeholders;
- Similar activities will be remunerated in a similar way;
- In principle, avoidance of tax controversy and lengthy discussion between tax authorities and taxpayers;
- Ability to allocate scarce resources to issues that pose a greater tax risk, in particular helpful for developing economies;
- Objective application; and
- Regular updates of the fixed margin to mirror a market return.

In order for a fixed margin to be used appropriately, it is essential that all stakeholders agree on the quantum of the fixed margin and under what conditions it can be used. It is also important that any fixed margin remains relevant in determining the appropriate return. To that end it is necessary to update periodically the fixed margin.



As Table 3 above suggests, different economies are characterized by different profit margins. It may therefore be difficult to arrive at a one-size-fits-all margin. Regional fixed margins may possibly be an outcome, upon conditions that such regional margins are also recognized by all countries (including those not in the region). BEPS Actions 8-10 Final Report Summary on aligning transfer pricing outcomes with value creation on the issue of low value-adding intra-group services indicates that fixed returns must be adopted and applied on a geographic scale that is as broad as possible, in order for such simplification measures to be effective. It would therefore be essential that the IF adopts and applies the Amount B approach in the same or similar way.

On the other hand, the use of fixed margins embeds an inherent risk of wrongful use of the margin into the system (similar to misuse of a safe harbour):

- Tax authorities may claim the use of the fixed margin although the effective margin of the taxpayer is lower; or
- Taxpayers may claim the use of the fixed margin although the effective margin for remunerating the activities is higher (and the tax authorities have no resources to argue the activities go beyond the baseline level).

In that respect, it seems likely that Amount B will not reduce controversy as tax authorities will want to retain the prerogative to assert that marketing and distribution functions go beyond the baseline of routine level (and fall under Amount C).

Question 7. Amount C and dispute prevention/resolution

As described above in Question 5, the new taxing right of Amount A based on residual profit creates the conditions for a multiplicity of disputes regarding the amount of the residual profit, the identity of the surrender state, the amount of income adjustments deemed to flow to the market states, and even the identity of such market states.

In our view, existing approaches to dispute resolution are likely to be incapable of dealing with the issues without the addition of new approaches. Traditional dispute resolution measures such as MAP and APAs still function primarily as bilateral instruments and, while there are good outcomes from these procedures, they struggle to work effectively on a multilateral basis. Even as bilateral instruments, the time taken to reach resolution is slow, and there are still too many instances of bad practice where jurisdictions block access to MAP in the first place or deny taxpayers their right to choose the venue of dispute resolution, along with frequent unwillingness to apply MAP settlements prospectively.

The experience with joint or simultaneous audits to date shows some success, but their use is probably limited to a restricted number of countries, often based in the same geographic region.



To the extent that either type of audit is utilised, the involvement of relevant competent authorities in the process is critical, as is the inclusion of the tax administration of the principal company or MNE group parent, which is often seemingly deliberately excluded, leading to the need for a further procedure such as MAP to resolve the resulting double taxation. The end result is that bilateral/multilateral audits are likely to be not practical or effective except in limited situations and will require a large allocation of resources from tax administrations.

Disputes regarding Amount A

Just as Amount A is an innovation, so we believe we would need to find innovative approaches to provide simple effective ways of agreeing to the amount to be treated as Amount A, ensuring that surrender states receive a deduction that falls outside the ALP and that market states are correctly identified and can tax Amount A. To give taxpayers certainty on Amount A, a taxing right for market states and a relief provision for surrender states may require a new multilateral convention that goes beyond solely amending bilateral agreements.¹⁶

As noted above, a clearer articulation of the intended source of Amount A is required in order to develop appropriate dispute resolution mechanisms (i.e. is this intended to be taken from “above normal”/ “residual” profits, or all non-routine profits?).

Given that the number of market jurisdictions for an MNE could be substantial (and sometimes over 100), allowing all of these countries to participate in this process is simply unworkable. We appreciate that leaving the determination to the MNE alone or to the taxing authority of the MNE’s parent company jurisdiction may be unsatisfactory to the market jurisdiction, but we submit that an open-ended process will lead to disagreements and disputes that will be costly, time-consuming, and difficult to resolve. Moreover, any adjustments are likely to ripple through the tax filings and amounts owed to all of the other countries where the MNE has a tax liability.

One way of providing greater certainty could begin with the MNE parent company taking responsibility for the calculation and allocation of Amount A to each market jurisdiction, together with giving the tax administration of the country of the parent company the authority to audit and determine the tax liability and allocation of Amount A (home state determination). This would be followed by a new multilateral approach - possibly using the existing competent authority network and overseen by a body such as the Forum on Tax Administration (FTA) or regional organisations of tax administrations - to confirm the allocation of the Amount A due to each market jurisdiction, with the competent authority of the MNE parent company taking the lead. The confirmation process would be there to enable the calculations to be verified and check any potential bias towards the MNE parent company jurisdiction which might inappropriately reduce Amount A. To give certainty within a reasonable time period, the confirmation process

¹⁶ Grinberg, Itai, "International Taxation in an Era of Digital Disruption: Analyzing the Current Debate" (2019). *Georgetown Law Faculty Publications and Other Works*. 2145. <https://scholarship.law.georgetown.edu/facpub/2145>.



would need to be time-limited and consent would probably need to be assumed if no representations from a country were received.

Some rules would be required if at the end of the period there was still disagreement on the amount of, or allocation of, Amount A. This might be a new panel, such as a standing committee or advisory commission of designated members drawn from across the FTA (possibly advised by the FTA Secretariat) that would ultimately have the right under the new MLI to determine Amount A and its allocation to all market jurisdictions.

Disputes regarding Amount B

By way of contrast, Amount B seems unlikely by itself to lead to increased numbers of disputes once the framework for agreeing Amount B is settled. This in itself will not be an easy or straightforward task if Amount B is to reflect differing industry and/or regional profiles. The assumption is that this will also need to be decided through a process that is led centrally by a body such as the FTA.

Greater certainty would be achieved if Amount B is a fixed return and is not a safe harbour for baseline marketing and distribution activities. A safe harbour could lead jurisdictions to argue that they had grounds to require more than B or a B+, therefore (partly) negating the purpose of Amount C and might also, or as well as, lead MNEs to file a lower than Amount B return in the market jurisdiction on the basis that they thought this was an arm's length amount, thereby potentially triggering a dispute that might need to be resolved, possibly through a form of MAP.

Disputes regarding Amount C

There will clearly be cases where the marketing and sales functions require greater reward than Amounts A and B, which we understand would be rewarded under Amount C. For those MNEs carrying on a sales and marketing operation in a territory where they have a taxable presence, there needs to be a similar arrangement for Amount B as for Amount A through a new MLI that would determine the baseline return for Amount B and a mechanism for taxing this in the market jurisdiction and relieving this in the surrender state(s).

The risk of disputes that cannot be easily resolved increases significantly with Amount C. The smaller the level of the baseline return covered by Amount B, and if Amount A is itself relatively small or even nil due to losses at the MNE level, the greater the attention on Amount C. Amount C is intended to cover not just those marketing and distribution functions that go beyond the baseline level of functionality, but also all other business activities unrelated to marketing and distribution that take place in that jurisdiction — including presumably those that are undertaken by other related entities to the marketing and distribution ones.

If an adjustment is made to Amount C by a market jurisdiction, this may give rise to a dispute between that jurisdiction and the relevant entity within the MNE group and the possibility of



double taxation if that dispute cannot be resolved either unilaterally through a mitigation of the adjustment in the market jurisdiction or through another mechanism that would seek to eliminate the double taxation through bilateral measures. There is also the possibility of multiple disputes between market jurisdictions and other entities in the same MNE group. Some MNE groups currently have dozens of such dispute and expend considerable resources and time in trying to resolve them while frequently failing to do so.

Under such a scenario, the “Unified Approach” may well have done little to give taxpayers any greater certainty and the many disputes that we see today in market jurisdictions will not be reduced. In fact, controversy may increase if taxpayers fail to reflect the real functionality of, and hence value created by, marketing and distribution activities, and if jurisdictions seek to maximise their take from Amount C by over-rewarding the activities undertaken. A question worth considering is the extent to which the number of such disputes might be reduced if Amount B was not a minimum amount but was instead set at a higher-level return for some jurisdictions in the IF who currently do not have access to the level of resources or expertise to manage their disputes with taxpayers, or to cope with a large Competent Authority workload.

One approach to improve dispute resolution arising from different views of the ALP under the “Unified Approach” would be to restrict access to the new taxing rights of Amount A and Amount B to only those market jurisdictions that sign up to participate in a form of mandatory binding arbitration in respect of Amount C. While, as noted above, arbitration plays an important role as the nuclear deterrent behind MAP, if it is to be used more frequently, the procedure would benefit considerably from being far more streamlined and standardised than it is today.

Where there is a dispute over Amount C between a market jurisdiction and the MNE parent company jurisdiction that is not resolved within the normal (or possibly a specially shortened) MAP period, this could be sent automatically to arbitration. A common and prescriptive format for presentation of cases and administrative procedures would provide greater consistency and should help to speed up the timetable for resolving a dispute. In addition, the creation of permanent standing panel members to deal solely with Amount C cases would create expertise and increase the consistency of outcomes. Such a panel could be independent of any particular jurisdiction.

A further step would be to make available the decision of cases in full or redacted form to other tax administrations, or even publicly. As mentioned above, baseball-type arbitration drives jurisdictions to their own resolutions and saves time as decisions of the panel are binary and no time is needed on forming a “third” view.

Alternatives to arbitration

Some countries and organisations have, however, already voiced concerns about arbitration involving an independent panel of arbiters, saying it represents an unacceptable threat to their



sovereignty. In order to accommodate this group of countries, an alternative approach would be required. A possible solution is a form of multilateral mediation, through the intervention of a panel of jurisdictions possibly run by the FTA and the MAP Forum, that could help both the market jurisdictions and the MNE jurisdictions reach a resolution that would resolve such disputes.

Such an approach might be offered to certain countries along with an enhanced Amount B if they did not benefit materially from Amount A, if their tax administrations were not sufficiently experienced or resourced to deal effectively with disputes, and if it was the case that this would significantly reduce the number of disputes experienced by MNEs in relation to their marketing and distribution activities around the world.

The OECD could also encourage these countries to adopt APA programmes to prevent disputes and provide certainty. APA programmes can be restricted, at least initially, to certain types of taxpayer, sectors and/or types of transactions. Limiting the scope of an APA programme to more routine activities, rather than more complex, IP-heavy, cases should enable a tax administration to develop expertise in dealing with a range of relatively standard business models and in understanding the value created by the sales and marketing functions carried on in their territory. Other members of the FTA with more experience negotiating APAs could assist by agreeing to negotiate bilateral APAs, even if the amounts at stake were relatively small, or even participating in multilateral negotiations to cover marketing and distribution activities across a region with comparable economic and market features.

Improvements in dispute prevention

But improvements and innovation in dispute resolution cannot cope with the number of disputes without also improvements in dispute prevention. A large proportion of the world's transfer pricing disputes relate to the relatively routine activities of sales and marketing. There is a tendency for some businesses to argue that because they describe an entity as a "limited-risk distributor" without convincing substantiation through a functional analysis, its transfer pricing should therefore reflect only a limited-risk return. Similarly, there is a tendency for some tax jurisdictions to over-value the contributions made locally to marketing intangibles that are economically owned elsewhere, and to equate large sales figures with large returns to the distributor.

In our view, there is a need for better OECD guidance to improve compliance by taxpayers and to assist tax auditors to do a better job in understanding the value of those sales and marketing functions. Given the prevalence of transfer pricing disputes in this area, the Transfer Pricing Guidelines need to better address the value created by distribution entities as a topic, supported by further guidance and training on business models and value chain analysis. The aim would be to encourage a more thoughtful approach to the application of the ALP by both taxpayers and tax



administrations and reduce the number of adjustments made by tax administration in respect of distribution activities that frequently end up in MAP.

Question 7.a (unilateral or multilateral) APAs

APAs still function primarily as bilateral instruments and, while there are good outcomes from these procedures, they struggle to work effectively on a multilateral basis. Even as bilateral instruments, the time taken to reach resolution is slow, and getting slower.

Multilateral APAs largely exist in name only. They are a goal to aspire to but are virtually non-existent except in very limited situations (for example in certain parts of the financial services sector or international infrastructure or defence projects). We provide further information on this topic in Appendix B.

Question 7.b ICAP

Multinational programmes such as ICAP appear to provide a promising process in principle that could be adapted for the purposes of the “Unified Approach”, but there is very limited experience to date and ICAP has only involved a restricted set of jurisdictions and companies so far. It seems highly questionable whether ICAP is scalable even to cover cases subject to the Unified Approach without a substantial reallocation of resources by tax administrations around the world to it. Moreover, ICAP does not yet offer enough certainty, particularly when we see some ICAP participants are already experiencing new audits on other issues. See Appendix B for further information.

Question 7.c Mandatory binding MAP arbitration

Linked to better guidance and training is the need for further improvements to existing MAP procedures. Greater scrutiny of audit work by the competent authority in the market jurisdictions before adjustments are made would help prevent unfounded and unrealistic adjustments being taken through MAP. But in too many other cases, the competent authority does not have the authority, whether real or in practice, to reduce audit adjustments before MAP is engaged. Without greater support from more senior officials, the competent authority may lack the authority to concede cases early before MAP enters the bilateral phase.

Arbitration has proven to be effective, largely because it exists as a threat rather than a reality. In Europe there appears to have been only a handful of arbitration cases in relation to transfer pricing. However, the very use of an independent panel of experts to determine the outcome of a tax dispute clearly gives a number of jurisdictions (including very large countries likely to benefit from Amount A) concerns that they lose their sovereignty as a nation state. But where it can be used, the prospect of a ‘baseball-type’ arbitration, in which the panel simply chooses one jurisdiction's view over another, will often drive a jurisdiction from an unreasonable or unjustified position.



As more countries ratify the existing MLI and bring its provisions into effect, we expect to see the number of cases going to arbitration increasing. And while the MLI creates the possibility of a more standardised approach to arbitration, the procedure is still largely bespoke to each case. This is inefficient and creates its own delay as countries take differing positions on the type of expert for the panel, or the place of arbitration, etc. Arbitration is only useful to both taxpayers and tax administrations if strong rules and strict timelines are put in place and are accepted by all countries to resolve cases quickly and efficiently. Success in this regard should be measured by how seldom it is used, rather than its frequency. See more details in Appendix B.

Next steps

For any clarification of this response, please contact the undersigned or any of the individuals below. We look forward to discussing any questions you might have on the points we raise above or on other specific matters raised by respondents to the invitation for public input, and we welcome the opportunity to contribute to the discussion as part of a public consultation meeting to be held on 21 and 22 November 2019.

Yours sincerely,

A handwritten signature in dark ink, appearing to be 'Stef' followed by a long horizontal stroke.

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Appendix A: High level analysis for Return under Amount B - Based on ROS

Global Approach

Based upon our high level limited analysis, the use of a global fixed percentage under Amount B would lead to the following results:

	Wtd. Avg.	2018	2017	2016	2015	2014
Lower Quartile	0.53%	0.49%	0.49%	0.56%	0.48%	0.44%
Median	1.48%	1.55%	1.50%	1.56%	1.46%	1.36%
Upper Quartile	3.13%	3.44%	3.35%	3.37%	3.19%	2.96%

Industry approach

PwC also performed a high level limited analysis for certain industries (automotive, pharma and consumables). The use of industry approaches for a fixed percentage would lead to the following results:

Automotive industry, based upon NACE codes: 451 – Sale of motor vehicles, 453 – Sale of motor vehicle parts and accessories, 4532 – Retail trade of motor vehicle parts and accessories; and SIC codes: 501 – Motor vehicles and motor vehicle parts and supplies wholesale dealing in, 551 – Motor vehicle dealers (new and used), 552 – Motor vehicle dealers (used only), 553 – Auto and home supply stores, 557 – Motorcycle dealers

	Wtd. Avg.	2018	2017	2016	2015	2014
Lower Quartile	1.03%	0.93%	0.96%	1.00%	0.98%	0.44%
Median	1.89%	1.85%	1.95%	1.94%	1.92%	1.87%
Upper Quartile	3.66%	3.69%	4.01%	4.02%	3.68%	3.74%

Pharmaceutical industry, based upon NACE codes: 4646 – Wholesale of pharmaceutical goods, 4773 – Dispensing chemist in specialised stores; and SIC code: 512 – Drugs, drug proprietaries and druggists' sundries.



	Wtd. Avg.	2018	2017	2016	2015	2014
Lower Quartile	0.88%	0.94%	0.75%	0.94%	0.87%	0.90%
Median	2.10%	2.27%	1.95%	2.13%	2.17%	2.05%
Upper Quartile	5.06%	4.99%	4.88%	5.01%	4.88%	4.68%

Consumable goods, based upon NACE codes: 462 – Wholesale of agricultural raw materials and live animals, 463 – Wholesale of food, beverages and tobacco, 472 – Retail sale of food, beverages and tobacco in specialised stores and 4781 – Retail sale via stalls and markets of food, beverages and tobacco products; and SIC codes: 51 – Wholesale trade, nondurable goods and 54 – Food stores

	Wtd. Avg.	2018	2017	2016	2015	2014
Lower Quartile	0.33%	0.32%	0.30%	0.34%	0.33%	0.26%
Median	1.02%	1.08%	1.03%	1.08%	1.01%	0.90%
Upper Quartile	2.39%	2.58%	2.49%	2.49%	2.42%	2.31%

The issues to be solved for and industry based percentage are:

- Agreement of industries (codification - broad or narrow description)
- Methodology for determining the fixed percentage
- Marketing and distribution activities covering several industries or business lines

Regional approach

Further to the global and industry high level analysis, we also performed a high level regional analysis for Asia and the Pacific, the Americas, and EMEA.

Asia and the Pacific (Geographical region: Far East and Central Asia, and Oceania)

	Wtd. Avg.	2018	2017	2016	2015	2014
Lower Quartile	0.42%	0.34%	0.35%	0.43%	0.37%	0.33%
Median	1.16%	1.18%	1.19%	1.25%	1.15%	1.11%



Upper Quartile	2.45%	2.61%	2.54%	2.59%	2.51%	2.29%
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Americas (Geographical region: North America and South and Central America)

	Wtd. Avg.	2018	2017	2016	2015	2014
Lower Quartile	1.16%	1.19%	1.48%	1.79%	0.54%	0.34%
Median	3.07%	2.84%	3.59%	4.29%	2.40%	2.22%
Upper Quartile	5.40%	9.14%	5.55%	6.71%	5.50%	5.17%

EMEA (Geographical region: Western Europe, Eastern Europe, Scandinavia, Baltic States, Nordic states, Balkan states, Middle East and Africa)

	Wtd. Avg.	2018	2017	2016	2015	2014
Lower Quartile	0.85%	0.71%	0.79%	0.81%	0.73%	0.65%
Median	1.97%	2.08%	2.03%	2.02%	1.99%	1.87%
Upper Quartile	4.13%	4.30%	4.33%	4.32%	4.26%	4.04%

With regard to a possible regional approach, the issues mentioned above are also valid. Other questions to be addressed are:

- Agreement on territories covered by the regions (country specific, regional, subregional)
- Activities covering multiple regions - for example global marketing



Appendix B: PwC's experiences with existing prevention and resolution mechanisms

Currently, there is no silver bullet that limits, prevents, or resolves audit risk for most MNEs for most transactions and operations in most countries of the world. There is no existing mechanism that can achieve these results; rather, there is a patchwork of alternatives that are not working in an optimal way.

a. (unilateral or multilateral) APAs

Unilateral APAs have the advantage in that they can often be agreed quickly with the one tax administration involved and may be appropriate if there is no obvious counterparty to the transaction, or the size of the transaction does not merit the other tax administration becoming involved.

However, where there is no counterparty to the agreement, unilateral APAs can only provide a certain level of certainty as audits in other jurisdictions may well lead to conflicting conclusions. The tax administration in a unilateral case often appears to seek an outcome that is over and above the ALP. Both situations create double taxation which is very often left unresolved by the taxpayer.

Bilateral APAs are often usually lengthy and fact-intensive, deal with complex issues, and consequently are expensive for taxpayers and resource-intensive for tax administrations. Many jurisdictions limit the number of APAs they will negotiate at any one time through a combination of admission fees, resource constraints, and complexity/controversy thresholds. While the bilateral APA is a key instrument in the prevention and resolution of disputes, bilateral APAs are therefore best reserved for the more difficult or contentious cases given their resource intensity and timelines. They are not likely to be a viable solution for routine cases and tax administrations are unlikely to be able to scale up to respond to large volumes of APA requests.

There is limited experience of actual **Multilateral APAs**, but these can be effective where they are focussed on specific projects (e.g. in the fields of defence or large infrastructure) and if all parties have incentive to reach agreement. For the most part, however, multilateral APAs exist in name only - being largely a slow-moving collection of bilateral APAs. In the new world order under BEPS 2.0, are they really a realistic alternative? Can we really bring 3, 5, 10, or more countries together to negotiate a complex multilateral APA?

b. ICAP

The ICAP procedure appears to provide a promising process in principle, but there is very limited experience to date and it involves a restricted set of countries and companies so far. It seems highly questionable whether ICAP is scalable even to cover cases subject to the "Unified Approach". Given that only 8 companies were subject to the initial pilot, it is hard to see how the



program could include upwards of 250 companies without a massive allocation of resources by tax administrations around the world.

In addition, the “comfort letter” approach does not provide enough certainty, particularly when some ICAP participants are already experiencing new audits on other issues. If the outcome is not binding, there is limited value for business participation. There is also the perception that some countries view it more as an alternative audit approach than a cooperative approach leading to more certainty.

c. Mandatory binding MAP arbitration

The use of mandatory binding MAP arbitration has succeeded to date as a deterrent; although there is very little experience of it being used, so far it seems to be effective. “Baseball-style” arbitration creates an incentive for competent authorities to reach agreement and reduces time for the panel to produce a decision. Perhaps one key weakness is that countries that should participate do not as they fear a perceived loss of sovereignty.

Arbitration is only useful to both taxpayers and tax administrations if strong rules and strict timelines are put in place and are accepted by all countries to resolve cases quickly and efficiently. Success in this regard should be measured by how seldom it is used, not by how frequently it is used. It is also true that not all cases can go through mandatory binding arbitration; this alternative will only work as part of a comprehensive revamping of the MAP process so that most cases are resolved in MAP and never need to go to binding arbitration.

d. Joint Audits / Simultaneous Audits

Both of these programmes show some limited promise, but they are not practical as a mechanism to audit large numbers of MNEs around the world. Experience of joint audits is increasing, and these can be effective in resolving disputes when the participating jurisdictions come from the same region where economic and market conditions are comparable. Successful joint audits often rely on the participation of larger jurisdictions in the region which have the resources to undertake the bulk of the work and to share it with all participants.

One key issue with joint audits is that jurisdictions usually have to be invited by the lead country to participate. Sometimes the principal company or the MNE parent is excluded from the joint audit, presumably on the grounds that this seemingly strengthens the hand of those jurisdictions seeking to challenge the transfer pricing and the reward going to the entrepreneur, IP holder, etc. This tactic however can lead to a large number of adjustments in audit jurisdictions that then require their own MAP procedures, which is highly inefficient. A better way would be to involve the principal/parent/IP holding company from the outset and build into the process the means to eliminate any double taxation arising in the first place.



At present, the use of joint audits to resolve significant numbers of disputes is not sufficiently developed to be a practical or effective remedy except in limited situations and where a large allocation of tax administrations resources is available.

e. MAP Process

MAP has a remarkable track record of resolving disputes to give full relief of double taxation, but the process is often slow and can lack transparency and accountability. Therefore, significant and critical improvements to the MAP process must be made; not only in line with those that are part of Action 14, but also far beyond those recommendations. In the new order after BEPS 2.0, there will be more pressure than ever on the practical and effective use of any MAP alternative.

Currently, there are still too many examples of bad and/or inefficient practices that arise during the MAP process, including: denial of access to MAP; denial of taxpayer rights to choose the venue of dispute resolution; and an unwillingness to apply MAP settlements proactively. There is also a lack of authority to “do the right thing”; this typically results from fear of consequences or lack of senior support.