A Unified Approach to Pillar One

Mumbai, 5 December 2019

OECD
BETTER POLICIES FOR BETTER LIVES

The “Unified Approach”

Objective

Design a solution that would:

- address the nexus and profit allocation for large MNE groups that
  - project themselves into the daily lives of consumers (including users);
  - engage with their consumer base and create material value in a sustained and meaningful way
  - without a traditional physical presence in the market
- achieve least complexity
- coexist with Arm’s Length Principle (ALP) and limit disruptions
- avoid double taxation and tax disputes
- lead to a consensus

The Unified Approach – Overview (I)

Model based on a three-tier mechanism…

Three separate returns can possibly be allocated to market or user jurisdictions

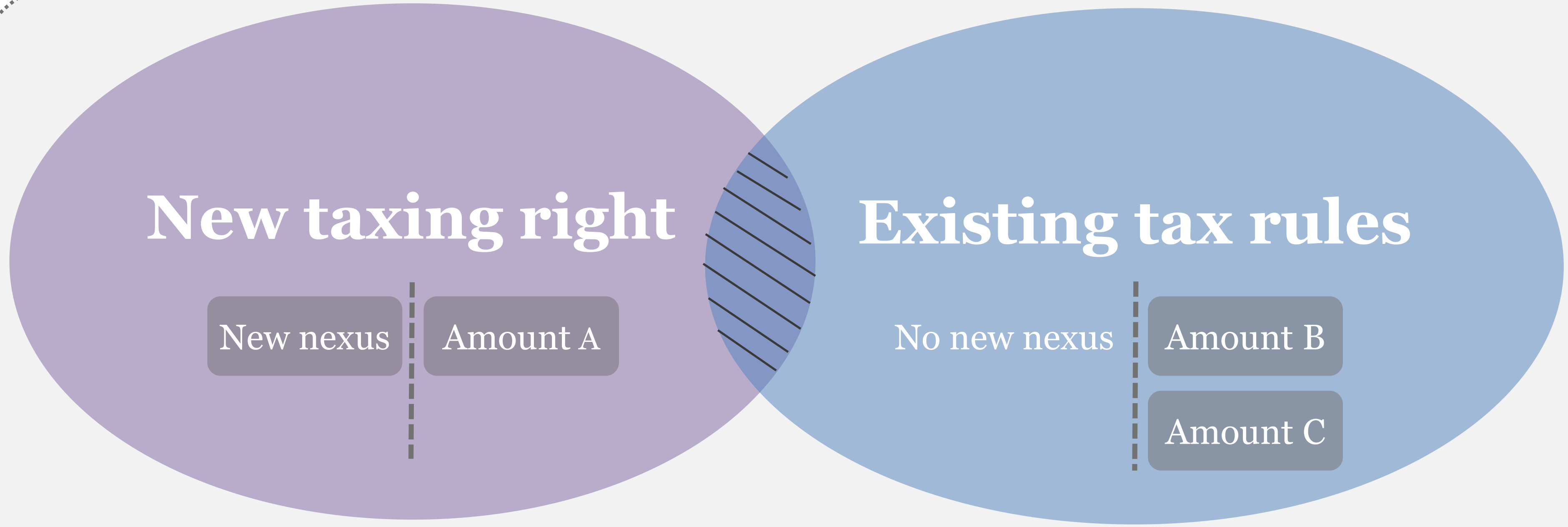
Amount A
Portion (%) of deemed residual profit

Amount B
Fixed return for baseline distribution functions

Amount C
Additional return for activities exceeding those covered in Amount B based on TP analysis

The Unified Approach – Overview (II)

… which leads to the co-existence of two systems



Robust and effective dispute prevention and resolution mechanisms

The “Unified Approach”

Scope

Large digital and consumer facing businesses

New nexus rule

MNE group level, unconstrained by physical presence

New profit allocation rules

Formulaic, MNE group level, beyond the ALP

A

B

C

Elimination of double taxation

Robust tax disputes prevention and resolution

Businesses in scope

Digital and consumer-facing businesses

- Highly digitalised businesses and other businesses that engage with individuals in markets who consume their goods or services
  - Would include for example online search engine, online social media platforms, digital content streaming, personal computers and software, clothing, household products, etc.
- Sellers of consumer goods through intermediaries
- Franchise and business models that license the right to use consumer products (e.g. audio streaming platforms providing music)

Large size MNE group/business

- Possible indicator: global revenues / revenues from consumer-facing businesses

Businesses not in scope

Non consumer-facing businesses

- Businesses that do not sell consumer products
  - sellers of raw materials, commodities;
  - producers and sellers of finished products used for commercial purposes, such as industrial machinery.
- Some borderline cases
  - businesses dealing primarily with business customers
  - intermediate goods and components

Further exclusions

- Work is on-going on which industries or sectors should, for the avoidance of doubt, be scoped out

Nexus

New nexus rule unconstrained by physical presence

- In an increasingly digitalised economy, large businesses engage with consumers (users) in market remotely
- New nexus rule would measure an MNE group sustained and significant engagement in the economy of a market
- Scope already identifies consumer-facing businesses which usually engage remotely with users/consumers through activities such as data collection and exploitation, and marketing and branding
- Therefore, additional nexus indicators specific to the market would look mainly at a revenue threshold, with adaptations to take into consideration the size of the market
- Standalone provision to avoid spill over effects

Nexus – Revenue threshold

Revenue-sourcing rules

- Design rules that balance different objectives:
  - easy to administer yet accurate;
  - based on readily available information, but avoid distortion or manipulation;
  - address both traditional and highly digitalised businesses (such as online advertising).
- Work is on-going on the design of specific and hierarchical revenue-sourcing rules that would balance these objectives.

Profit Allocation

Model based on three separate returns to the market/user jurisdiction

Amount A

- New taxing right to market/user jurisdiction
- Independent of physical presence
- Formulaic approach based on group/business line profits
- No links to ALP

Amounts B & C

- No new taxing right – merely a modified operation of the ALP
- Follows the separate entity approach

Profit Allocation
Amount A – new taxing right

Step 1: Determination of total profit

- MNE group or business-line calculations

Step 2: Exclude "deemed" routine profit to define residual

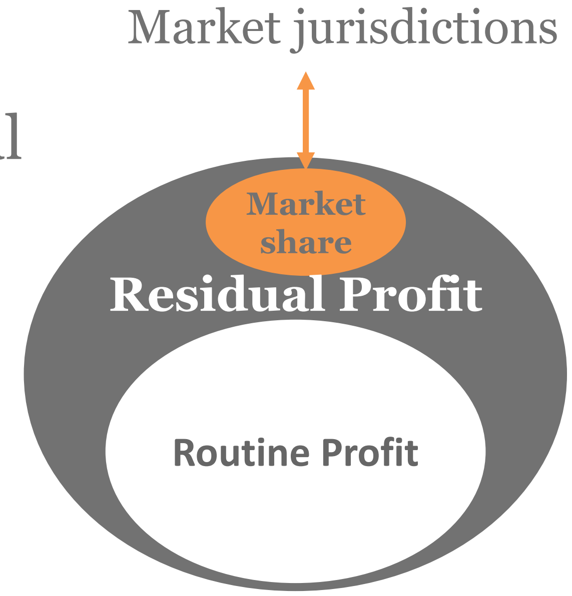
- Profitability threshold (i.e. fixed percentage(s))

Step 3: Allocate a portion of "deemed" residual profit

- Formulary (i.e. fixed percentage(s))

Step 4: Allocate the relevant portion of the deemed residual among market jurisdictions

- Agreed allocation key (e.g. sales)



Profit Allocation Amounts B and C

Amount B

Objective

- Reduce disputes
- Achieve greater certainty

Method

- Fixed return for “baseline” or routine marketing or distribution activities in market

Amounts C

Objective

- Retain market jurisdiction right to tax profit above baseline activity
- Prevent double counting of Amount A

Method

- Apply current ALP to activities beyond baseline
- Introduce effective and binding dispute resolution mechanisms

Ongoing Work

- Definitions and quanta
- Differentiation for business models
- Use of financial accounting and business line segmentation
- Elimination of double taxation (incl. double counting)
- Treatment of losses
- Implementation and administration

Next steps

11-12 December 2019

- Meeting of the Steering Group of the IF

Jan 2020

- Inclusive Framework meeting