Response to the OECD Consultation on the Secretariat Proposal for a “Unified Approach” under Pillar One

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Table of Contents

1. About the Irish Tax Institute 3
2. Executive Summary 4
3. Definition of Scope 7
4. New Nexus and Profit Allocation Rules 8
4.1 Amount A 10
4.2 Amount B 12
4.3 Amount C 13

1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. With over 5,000 members in Ireland, along with the Chartered Institute of Taxation UK and The Tax Institute of Australia, we are part of the 30,000-strong international CTA network and a member of *CFE Tax Advisers Europe*, the European umbrella body for tax professionals.

Our members provide tax education and expertise to thousands of businesses, multinationals, and individuals in Ireland and internationally. In addition, many hold senior roles within professional service firms, global companies, Government, Revenue, state bodies and the European Commission.

After 50 years, the Institute remains deeply committed to the role it can play in education, tax administration and tax policy in Ireland and in building an efficient and innovative tax system that contributes to a successful economy and society. We are also committed to the future of the tax profession, our members and our role in serving Ireland's taxpayers and best interests in a new international world order. Our *Irish Tax Series* publications and online database *TaxFind* are respected and recognised as Ireland's most extensive tax information sources.

Irish Tax Institute - Leading through tax education.

2. Executive Summary

Introduction

The Irish Tax Institute welcomes the opportunity to contribute to the public consultation on the OECD Secretariat proposal for a “Unified Approach” under Pillar One, to address the tax challenges of the digitalisation of the economy. We note that the proposal has been prepared by the Secretariat and does not represent the consensus view of the Inclusive Framework, the Committee on Fiscal Affairs or their subsidiary bodies.

The proposal seeks to build on the commonalities of the three alternative approaches proposed under the Programme of Work[1] on Pillar One and aims to identify key features of a solution that would:

- Identify the businesses that are within the scope of the new rules
- Provide for new nexus and profit allocation rules that would not depend on physical presence in the user/market jurisdiction and go beyond the arm’s length principle
- Increase tax certainty for businesses, delivered through a three-tier approach to profit allocation.

We recognise that reform of the international tax framework is necessary to ensure that countries can reach a stable global consensus on how and where companies should be taxed in a digitalised world.

Given the importance of tax certainty for taxpayers, which has been recognised as a key factor that influences investment and other commercial decisions which impact economic growth, we believe that sufficient time should be given to consider such significant reforms to the international tax framework. In fact, continued consultation with stakeholders will be necessary, as the technical details develop, to ensure a robust and workable solution can be reached that is sustainable in the long term.

Removal of unilateral digital tax measures

Consideration must also be given to the plethora of unilateral digital tax measures that have already been introduced by many countries or are in the process of being enacted which impose tax on a gross basis. In our view, any consensus approach agreed by the Inclusive Framework, to address the tax challenges arising from the digitalisation of the economy, should also address those unilateral measures, in an effort to limit the risk of double or indeed, multiple taxation.

We firmly believe that countries taking part in the reform process should give a commitment to remove existing digital tax measures that have been unilaterally introduced, when implementing any globally agreed solution that may be reached by the Framework and agree not to implement any new unilateral measures in the interim.

[1] OECD (2019), Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

In addition, countries taking part in the reform process should also commit not to introduce any new unilateral measures in the future that would target any agreed out-of-scope activities (carve-outs) from the new rules. The implementation of such commitments could be monitored under an OECD peer review process.

Certainty over the definition of scope

To ensure certainty for both taxpayers and tax administrations, there must be clear and comprehensive guidance on what type of businesses fall within the scope of the new rules. The current proposal provides that 'consumer-facing business' models would, by default, come within the scope of the new rules, unless they are subject to an exemption, such as a carve-out for extractive industries.

Considering the broad and ambiguous concept of 'consumer-facing business' models, it is extremely difficult to define which taxpayers would be in scope. In order for any solution to be sustainable there must be a clear economic rationale underlying the scope of the new rules that will define what constitutes a 'consumer-facing business'.

Given the significant administrative burden associated with the proposal, it would be vital that appropriate revenue and profitability thresholds are introduced to ensure that the new measures are confined to larger multinational enterprises that would be better resourced to deal with the heightened complexity of the new international tax framework.

Losses need to be addressed

We consider that the methodology for allocating residual profits to market jurisdictions should include the tax attributes of a business, such as the carry forward of losses and tax depreciation for investment in assets. Countries in which multinational enterprises have invested either during their start-up phase or in the development of a product should not have to absorb losses, while those multinational enterprises are paying taxes on profits elsewhere. It should not be the case that only profits are allocated to market jurisdictions, with losses being borne by the residence jurisdiction.

Availability of financial data

The consultation document acknowledges that the profitability of a multinational enterprise can vary substantially across business lines, regions and markets. The document suggests that the relevant measure of profits may need to be determined on a business line and/or a regional or market basis. It would be essential to consult closely with businesses regarding the practical implications of such an approach, as we understand that difficulties would undoubtedly be encountered by businesses to produce the financial information and data that would be required.

Binding effect of dispute resolution

Legally binding and effective dispute prevention and resolution mechanisms are clearly contemplated in the consultation document in the context of disputes regarding Amount C. In our view, all areas of the new rules should be subject to legally binding and effective dispute resolution mechanisms.

Potential areas of dispute are likely to arise in a number of areas, from such fundamental matters as to whether a business comes within the scope and the application of the new nexus rule, to the more detailed elements of the three-tier profit allocation mechanisms.

The dispute resolution mechanisms that competent authorities currently have in place, which are focused on dispute resolution in a bilateral context, could not effectively deal with the inevitable increase in disputes resulting from the measures envisaged which would be on a multilateral basis. Without a radical reform of the current dispute resolution mechanisms, double taxation disputes are likely to result in increased costs for businesses and they could ultimately impact decisions on whether to invest or indeed trade in a given jurisdiction.

We would suggest that the proposed rules should be contained in a new standalone multilateral instrument that would sit above existing double taxation agreements. By agreeing to accept the terms of such a multilateral instrument, countries would have to indicate their willingness to implement the new rules into domestic legislation, to comply with the new rules and to commit to the binding effect of dispute resolution to ensure that the rules would not result in double taxation.

Comprehensive guidance and peer review process
It would be important that comprehensive guidance would also be provided by the OECD, including country specific guidance, on the implementation of the new rules to ensure that there is uniform implementation across all countries in the Inclusive Framework. The implementation of the new rules could also be subject to an OECD peer review process. Consideration should also be given to the interaction of any multilateral instrument with the proposals under Pillar Two.

Conclusion
We believe that an internationally agreed tax framework is an essential tool which facilitates cross border trade and investment. However, adequate time must be given to the reform process to ensure a fully considered and practical solution is reached which will stand the test of time.

Undoubtedly, further consultation with stakeholders will be necessary when the full technical details of any proposed solution are reached, together with a comprehensive impact assessment of the potential economic and administrative consequences of any such proposal, on developed and developing economies and small and larger countries.

3. Definition of Scope

It is important that clarity is provided at an early stage in the reform process regarding the range of business models that fall within the scope of the new rules. This would provide the necessary tax certainty for taxpayers, which is recognised as a key factor that influences investment and other commercial decisions, with significant impact on economic growth.[2]

Given the determination of whether a business is within scope is fundamental to the application of the new rules, it should not be for any individual country to decide the matter where the issue is disputed. Consideration should be given to providing an appropriate forum to resolve such disputes, which would allow businesses to obtain certainty as to whether or not they are within the scope of the rules.

The consultation document proposes that 'consumer-facing business' models would, by default, be within the scope of the new rules, unless they are subject to an exemption, such as the carve-out mentioned for extractive industries. The concept of a 'consumer-facing business' put forward is ambiguous, in particular when it is suggested that businesses, which are not directly consumer facing and sell into a market through an intermediary (whether a related or unrelated local entity) could be considered a consumer-facing business.

The consultation document suggests the €750 million revenue threshold used for country-by-country reporting (CbCR) requirements could be considered to limit the types of companies that would be subjected to the new rules. We would agree that the measures envisaged should be confined, at a minimum, to larger multinational enterprises as they would be better placed to deal with the heightened complexity of the proposed new international tax framework.

It needs to be clarified whether the turnover threshold relates to the whole of the multinational group's business or whether it would be limited to revenue derived from in-scope activities. In addition to a revenue threshold, consideration should also be given to the application of an appropriate profitability threshold to determine whether a business comes within the scope of the new rules (or if relevant, any part of the new rules).

[2] IMF/OECD (2019), 2019 Progress Report on Tax Certainty, Paris. www.oecd.org/tax/tax-policy/g20-report-on-tax-certainty.htm

4. New Nexus and Profit Allocation Rules

Once it can be determined that a business is within scope, it is proposed that there would be a new nexus rule and profit allocation rule which would apply irrespective of whether a business has an in-country marketing or distribution presence or sells via unrelated distributors or intermediaries.

It is suggested that the new nexus rule would primarily be based on sales, which could have country specific sales thresholds calibrated to ensure that jurisdictions, with smaller economies, can also benefit.[3] Whilst it would be appropriate to adjust sales thresholds for the size of the economy, we believe it would be important for the thresholds to be defined by reference to a range to ensure that they would not need to be adjusted on a yearly basis. If a fixed figure is chosen, it would be necessary to ensure that it is not set at such low level, as to cause a disproportionate compliance burden.

In the case of a multinational company that uses intermediaries, it may not be aware of the destination of the end consumer or the sales derived therefrom, as often the same intermediary will make supplies into a number of countries. It should not be the case that a multinational company is obliged, in such circumstances, to look through the intermediary to determine the destination of the final consumer, where such data is not already in its possession. Indeed, sales made through third parties should not bring a business within the scope of the new rules unless the intended purpose of using a third-party intermediary is to avoid the application of those rules.

The consultation document states that the new nexus rule would be designed as a new 'self-standing' treaty provision.[4] Given that there may not be existing double taxation agreements in place between countries seeking to rely on the new rule, we recommend that the rule should be contained in a new standalone multilateral instrument that would sit above existing double taxation agreements. By agreeing to accept the terms of such a multilateral instrument, countries would have to indicate their willingness to comply with the new rule and commit to the binding effect of dispute resolution, which would be necessary to ensure that the rules do not result in double taxation.

The "Unified Approach" proposes a three-tier profit allocation mechanism, namely Amounts A, B and C, which is intended to increase tax certainty for both taxpayers and tax administrations.

Amount A would encapsulate the new taxing right which is not dependant on a physical presence and would see a share of the deemed residual profit allocated to market jurisdictions.

Amounts B and C would apply by reference to the presence of a traditional nexus in the market jurisdiction (a subsidiary or permanent establishment). Clear and comprehensive

[3] OECD (2019), Public consultation document Secretariat Proposal for a "Unified Approach" under Pillar One, page 5
[4] Ibid

guidance would be necessary to ensure that there could be no duplication of the profits accounted for under Amounts A, B or C. Where profits have been subject to tax in one jurisdiction, it would be appropriate for the exemption method to be applied if those profits are deemed to be allocated elsewhere. Such an approach could consider timing differences where income/gains are taxed in a different year from when the income/gain is recognised for accounting purposes.

4.1 Amount A

Amount A would essentially be a new taxing right for market jurisdictions over a portion of the deemed residual profit of an enterprise. This could potentially be calculated on a business line and/or regional or market basis. It is proposed that a formulary approach (with percentages to be determined by political agreement) would be adopted to allocate a portion of deemed residual profit of the multinational enterprise to market jurisdictions.

Whilst there may be some justification to recognise a portion of the residual profit to be allocated to value that may exist in the market jurisdiction, we believe that there must be a clear economic rationale underpinning the formula that would be applied in order for the regime to withstand the test of time.

The differentiation between deemed routine and residual profits is potentially a source of further conflict and dispute in determining the profit to be allocated to market jurisdictions under Amount A. Clear and comprehensive guidance by the OECD on these key concepts would be necessary to ensure that there is an unambiguous demarcation of lines between deemed routine and residual profits.

Whilst the determination of routine profits could be set by reference to economic research, consideration would need to be given to the review of such returns in the event of changes in economic conditions.

It should not be the case that only profits are allocated to market jurisdictions, with losses being borne by the residence jurisdiction. The computation of residual profits to be allocated must consider the investment made by multinational companies in creating and exploiting production or trade related intangibles, such as, expenditure incurred on R&D, in the commercialisation of scientific and technological developments and in driving production efficiencies and service enhancements.

We consider that a design principle for allocating a portion of the residual profit to the market jurisdiction should consider the tax attributes of a business, such as, carry forward losses and tax depreciation. Otherwise, countries in which multinational companies have invested either during their start-up phase or in the development of a new product may have to absorb losses, while such multinational companies are paying taxes on profits elsewhere. Any agreed methodology should also provide for start-up losses relating to the market jurisdiction, which can occur when developing new markets for products and services.

The consultation document proposes that the starting point for the determination of Amount A would be the identification of the multinational group's profits, as derived from the consolidated financial statements. In order to ensure transparency and consistency in financial information, it would be important that the consolidated financial statements are prepared in accordance with an existing internationally recognisable accounting standard, such as the International Financial Reporting Standards (IFRS) or US GAAP.

The consultation document notes that the profitability of a multinational group can vary substantially across business lines, regions or markets and suggests that the relevant measure of profits may need to be determined on a business line and/or a regional or market basis.

It would be essential to consult closely with businesses regarding the practical implications of such an approach, as we understand that difficulties would undoubtedly be encountered by businesses to produce such financial information and data that would be required. Segmental reporting for the purposes of the published accounts of a multinational company would not normally include details of profits before tax on a segmental basis. Multinational companies may operate multiple businesses within one legal entity, with resources spread over different business lines, for example, salespeople selling across a number of different business lines.

The administrative burden of the proposals for business should not be underestimated and it may even be necessary in certain circumstances for a reorganisation to take place in order for the business to be in a position to provide the financial information envisaged.

Indeed, the requirements of CbCR necessitated many businesses to build additional reporting systems to enable them to meet the reporting requirements, notwithstanding that the starting point for such reporting was the financial statements. It can be expected from the experience of CbCR that the proposals outlined in the consultation document will require further reporting systems to be built, with the complexity of those systems increasing in line with the granular level of detail required.

A group profitability threshold may be the most straightforward for business. However, as profitability in many instances will vary across business line and regions, the choice to segment by region or business line could lead to varying results for different countries. If it is left open to individual countries to decide which option should be applied, this could result in a never-ending plethora of disputes.

Paragraph 39 of the consultation document proposes the imposition of a withholding tax as a collection mechanism and enforcement tool where the tax liability for Amount A is assigned to an entity that is not resident in the taxing jurisdiction. The imposition of a withholding tax obligation on an intermediary would result in a significant administrative burden in circumstances where the intermediary may be a less well-developed business, without the capacity to deal with such a compliance obligation. Such an obligation could require businesses to re-negotiate such third-party contracts.

As Amount A is likely to involve allocations that have multilateral and not just bilateral impact, new and distinct binding effect dispute resolution mechanisms would be necessary to ensure that there is a clear mechanism to resolve multilateral disputes. Potential areas of uncertainty could include the identification of appropriate financial data relating to the marketplace, which would be needed to ensure that the formula in respect of Amount A could be applied correctly. For example, a multinational company that uses intermediaries may not be aware of the destination of the end consumer or the revenue derived therefrom.

The resources required for tax authorities to deal with such disputes should not be underestimated. Therefore, an appropriate dispute resolution mechanism should be jointly constructed by both developed and developing countries working together, to ensure that a common, well understood system can be implemented in practice.

In order to ensure that it is not necessary for multiple returns to be filed in the various market jurisdictions, a "one stop shop" mechanism, similar to that which applies for CbCR in our view would be appropriate. This could be achieved by the multinational enterprise submitting details to the tax authority of its parent jurisdiction of the "Amount A" determination and allocation.

A framework for the exchange of such returns with affected jurisdictions could be established, which would remove any local filing obligations for affected multinational enterprises. With a view to minimising the number of potential audits for taxpayers, the right to audit such returns should rest solely with the parent jurisdiction in which the return is filed. However, the payment of any underlying tax due would be made by the multinational enterprise to the local tax authority.

4.2 Amount B

The "Unified Approach" proposal envisages that Amount B would consist of a fixed return for certain baseline or routine marketing and distribution activities that take place in the market jurisdiction. We understand that the purpose of Amount B is to simply solidify existing transfer pricing principles in an attempt to reduce the risk of double taxation, rather than to generate extra revenues for market jurisdictions.

Simplified business models, where routine and non-routine functions are carried out by separate entities cannot be assumed, as a single entity will often undertake both routine and non-routine activities. Indeed, an entity engaged in marketing and distribution activities may also interact with other entities in the supply chain, such as those engaged in manufacturing whose activities would be subject to transactional-based transfer pricing, using the long-established arm's length principle.

In such a scenario, tensions could arise where the application of a fixed return for certain baseline marketing and distribution activities allocated under Amount B could result in insufficient profits left to be allocated to other entities in accordance with the arm's length principle under transactional-based transfer pricing. It would be essential that an appropriate balance is achieved in setting any baseline and that any proposed solution should incorporate a methodology for resolving such disputes.

Certainty regarding the definition of routine profits that would be acceptable as a baseline amount would be welcomed. However, such baseline returns would need to be reviewed in the event of a significant change in economic conditions or in the event of an update to best practice, as may be set out in OECD guidelines on transfer pricing.

If a globally acceptable baseline return becomes established, it would have the potential to become a safe harbour guideline for smaller companies (falling outside the scope of these rules), which could potentially reduce the complexity of establishing the baseline return for such companies and taxing those profits, when breaking into new markets.

4.3 Amount C

The consultation document proposes that where the marketing and distribution activities which take place in the market jurisdiction exceed the baseline functions compensated under Amount B, that additional profit may be allocated to such activities where it is supported by the application of the arm's length principle. The activities envisaged under Amount C must be clear and relate to identifiable functions that are in addition to those functions rewarded under Amount B.

Furthermore, it would be vital to ensure that in establishing Amount C, that the profit under Amount A could not be duplicated in the market jurisdiction. For example, there must be clarity regarding the allocation of non-routine profits relating to trade related intangibles, such as, expenditure incurred on R&D, and associated entrepreneurial risk. Moreover, the total of Amounts B and C in all cases should be less than or equal to the stipulated level of profitability that is ultimately defined for Amount A.

We welcome the proposal that any dispute between the market jurisdiction and the taxpayer over any element of the new rules should be subject to legally binding and effective dispute prevention and resolution mechanisms. The interaction with the existing system of double taxation relief under the current bilateral tax treaty system would also need to be addressed.

Moreover, the dispute resolution mechanisms that competent authorities currently have in place, which are focused on dispute resolution in a bilateral context, could not effectively deal with the inevitable increase in disputes resulting from the measures envisaged which would be on a multilateral basis.

Without a radical reform of the global tax infrastructure and the current dispute resolution mechanisms, double taxation disputes are likely to result in increased costs for businesses, which could ultimately impact decisions on whether to invest or indeed trade in a given jurisdiction. Therefore, for any proposal to work effectively in practice the compliance burden and the risk of double taxation must be minimised, thus limiting the scope for disputes.

It is important that clarification is also provided at an early stage in this process regarding the proposed treatment of existing Advance Pricing Agreements (APA) when these new rules would come into force. Failure to do so could impact the willingness of businesses to engage in the APA process in the interim.