OECD/G20 Base Erosion and Profit Shifting Project

Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy

As approved by the OECD/G20 Inclusive Framework on BEPS on 29-30 January 2020

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Table of contents

Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy 4

Annex 1. Outline of the Architecture of a Unified Approach on Pillar One 6
- 1. Introduction 6
- 2. Overview 8
- 3. The New Taxing Right (Amount A) 9
- 4. The fixed Return for Defined Baseline Distribution and Marketing Activities (Amount B) 16
- 5. Tax Certainty: Dispute Prevention and Resolution 17
- 6. Implementation and Administration 19

Annex A. Programme of Work to Develop a Consensus-Based Solution to Pillar One Issues 22
- 1. Remaining work 22
- 2. Timeline 24
- 3. Organisation 25

Annex B. MNE Groups Impacted by Amount A 26

Annex 2. Progress Note on Pillar Two 27
- 1. Introduction 27
- 2. Status of the work and next steps 28

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1. In light of the strong support from the Inclusive Framework on BEPS (IF) members for reaching a multilateral agreement with respect to Pillar One and Pillar Two, and drawing on the technical work of the Working Parties, comments from the public consultation, as well as the discussion at a number of Steering Group meetings, and recognising the concurrent work on a without prejudice basis on the two pillars, **members of the Inclusive Framework affirm their commitment to reach an agreement on a consensus-based solution by the end of 2020. In further developing the two Pillars, the Inclusive Framework has therefore agreed upon an outline of the architecture of a Unified Approach on Pillar One as the basis for negotiations and welcomed the progress made on Pillar Two (which follows the outline of Pillar Two in the PoW) contained in Annexes 1 and 2 of this statement.**

2. With respect to Pillar One, the IF endorses the Unified Approach (set out in Annex 1) as the basis for the negotiations of a consensus-based solution to be agreed in 2020. The proposed reallocation of taxing rights under Pillar One would require improved tax certainty, including effective and binding dispute prevention and resolution mechanisms. In the design and implementation of the solution, the IF also acknowledges the need to minimise complexity.

3. Members note the technical challenges to develop a workable solution as well as some areas where critical policy differences remain which will have to be resolved to reach an agreement. They note a December 3 letter from the US Treasury Secretary to OECD Secretary-General Gurría reiterating the US political support for a multilateral solution and including a proposal to implement Pillar One on a ‘safe harbour’ basis. Many IF Members express concerns that implementing Pillar One on a ‘safe harbour’ basis could raise major difficulties, increase uncertainty and fail to meet all of the policy objectives of the overall process. The IF members note that, although the final decision on the matter will be taken only after the other elements of the consensus-based solution have been agreed upon, resolution of this issue is crucial to reaching consensus.

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4. IF Members also recognise there are a number of other issues where significant divergences will have to be resolved. These include (i) the binding nature of dispute prevention and resolution mechanisms as well as the scope of the dispute resolution mechanisms under Amount C; (ii) the suggestion by some members to weight the quantum of Amount A to account for different degrees of digitalisation between in-scope business activities (so-called “digital differentiation”); and (iii) the suggestion by some countries to account for regional factors in computing and allocating Amount A (through regional segmentation). Members note that concerns have been expressed by some jurisdictions and businesses about the continued application of Digital Service Taxes (DSTs).

5. With respect to Pillar Two, the IF welcomes the significant progress the working parties have been able to achieve on the technical design of the Pillar noting that more work needs to be done, as described in more detail in Annex 2.

6. The IF notes the good progress on the economic analysis and impact assessment of Pillars One and Two. The IF calls for continued efforts to strengthen the analysis with caution due to data limitations and for more detailed analysis on the investment and growth impacts of the proposals before the end of March 2020.

7. In this environment, IF members reaffirm their commitment to bridge the remaining differences and reach agreement on a consensus-based solution by the end of 2020, noting that this agreement will depend on the further concurrent work which will be carried out on the two pillars. An important step will be its next meeting in early July, at which it is intended to reach agreement on the key policy features of the solution which would form the basis for a political agreement.

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Annex 1. Outline of the Architecture of a Unified Approach on Pillar One

1. Introduction

1.1. Background

1. The tax challenges of the digitalisation of the economy were identified as one of the main areas of focus of the Base Erosion and Profit Shifting (BEPS) Action Plan, leading to the 2015 BEPS Action 1 Report.[1] For direct taxes, the Action 1 Report observed that while digitalisation could exacerbate BEPS issues, it also raises a series of broader tax challenges, which it identified as "nexus, data and characterisation". The latter challenges, however, were acknowledged as going beyond BEPS, and were described as chiefly relating to the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated among jurisdictions. Possible options to address these concerns were identified, but none were agreed or ultimately recommended as part of the BEPS package. Instead, the Action 1 Report called for continued work in this area with a further report to be delivered by 2020.

2. In March 2017, this timeline was accelerated at the initiative of the G20 Finance Ministers, who asked the OECD/G20 Inclusive Framework on BEPS (hereafter Inclusive Framework), working through its Task Force on the Digital Economy (TFDE), for an Interim Report, which was delivered in March 2018 (the Interim Report).[2] It contained an in-depth analysis of new and changing business models and possible implications for the international tax system (in particular nexus and profit allocation rules). The Interim Report also repeated the conclusion from the Action 1 report that it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy. While members of the Inclusive Framework did not agree on the conclusions to be drawn from this analysis, they committed to continue working together on the development of a consensus-based long-term solution by 2020, with an update in 2019.

3. To advance progress towards a consensus-based solution, Inclusive Framework members made a number of proposals, some of which focused on the allocation of taxing rights through modifications to the rules on nexus and profit allocation,[3] and others on unresolved BEPS issues.[4] The Inclusive

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[1] OECD (2015), *Addressing the Tax Challenges of the Digital Economy*, Action 1 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

[2] OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

[3] Namely, the "user participation" proposal, the "marketing intangibles" proposal and the "significant economic presence" proposal (see Public Consultation Document, Addressing the Tax Challenges of the Digitalisation of the Economy, 13 February – 6 March 2019, OECD).

[4] The Global anti-base erosion proposal (see Public Consultation Document, Addressing the Tax Challenges of the Digitalisation of the Economy, 13 February – 6 March 2019, OECD).

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Framework agreed a Policy Note in January 2019 that grouped the proposals into two pillars – one of nexus and profit allocation and another on ensuring a minimum level of taxation – and contained an agreement to examine them as a possible basis for consensus.[5] On Pillar One, the Policy Note recognised that in the balance are: the allocation of taxing rights between jurisdictions; fundamental features of the international tax system, such as the traditional notions of permanent establishment and the applicability of the arm's length principle; the future of multilateral tax co-operation; the prevention of unilateral measures; and the intense political pressure to tax highly digitalised MNEs.

4. Following the January Policy Note, the Inclusive Framework continued working on the proposals on a without prejudice basis, considering how the gaps between the different positions of jurisdictions could be bridged, and in March 2019 sought input from external stakeholders through a public consultation process.[6] Based on those inputs, the Inclusive Framework delivered a detailed Programme of Work (May PoW)[7] in May 2019. This was endorsed by the G20 Finance Ministers and Leaders in June 2019.

5. For Pillar One, the May PoW identified and allocated work to explore the different proposals articulated by members of the Inclusive Framework. It acknowledged the commonalities between the proposals, but noted that options available would need to be reduced and some gaps bridged in order to deliver a consensus-based solution on Pillar One. It further emphasised the need for an agreement on the outlines of the architecture of a unified approach by January 2020, to arrive at a consensus-based solution by the end of 2020.

6. Mindful of this goal, the Secretariat developed an approach to facilitate progress towards consensus on Pillar One (the so-called "Unified Approach") which built on the commonalities identified in the PoW, taking account of the views expressed during the March public consultation, and the need to deliver a solution that is acceptable to all members of the Inclusive Framework. After discussions at the Steering Group of the Inclusive Framework (SGIF) the proposal was discussed by the TFDE and further in the SGIF meetings in September and October 2019, and subsequently released to the public for comments on 9 October 2019.[8]

7. In less than five weeks, the Secretariat received 304 submissions exceeding 3,000 pages, covering both technical and policy aspects of the proposal. Stakeholders also expressed their views at the November Public Consultation meetings organised in Paris and Manila, which were attended by more than 500 representatives from governments, business, civil society and academia. During these consultations, respondents raised concerns on certain technical aspects of the proposed approach, including its complexity. Addressing these concerns and working on issues such as tax certainty, simplified compliance, dispute prevention and resolution, and elimination of double taxation, is essential and this note identifies different work streams to achieve this. Nevertheless, many were supportive of its objectives and guiding principles, provided it would effectively prevent the proliferation of unilateral measures, avoid double

[5] *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, as approved by the Inclusive Framework on BEPS on 23 January 2019, OECD 2019.

[6] The public consultation document was released on 13 February 2019 (Public Consultation Document, *Addressing the Tax Challenges of the Digitalisation of the Economy*, 13 February – 6 March 2019). The response from stakeholders was robust with more than 200 written submissions running to over 2,000 pages of written comments. Stakeholders had the opportunity to express their views at the public consultation meeting that was held in Paris on 13 and 14 March 2019, with over 400 attendees.

[7] 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.

[8] Public consultation document, *Secretariat Proposal for a "Unified Approach" under Pillar One*, 9 October 2019 – 12 November 2019.

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taxation and excessive compliance burdens, and restore stability and certainty to the international tax system.

1.2. Taking the Unified Approach forward

8. The Inclusive Framework welcomes the Secretariat's work to develop a "Unified Approach" to Pillar One. This document contains an outline of the architecture of a unified approach to Pillar One to use as the basis for the negotiation of a consensus-based solution to be agreed by mid-2020. This document is complemented by a separate revised Programme of Work for Pillar One (revised PoW) that defines the remaining work that needs to be undertaken by the end of 2020 (see Annex A). This revised PoW replaces the earlier Pillar One PoW that the Inclusive Framework adopted in May 2019.

9. It is expected that any consensus-based agreement must include a commitment by members of the Inclusive Framework to implement this agreement and at the same time to withdraw relevant unilateral actions.

2. Overview

10. The unified approach outlined in this document is designed to adapt taxing rights by taking into account new businesses models and thereby expand the taxing rights of market jurisdictions (which, for some business models, is the jurisdiction where the user is located).[9] This is intended to re-stabilise the international tax system, assisted by enhanced dispute prevention and resolution procedures. To achieve these results, the approach encompasses three types of taxable profit that may be allocated to a market jurisdiction: these are described as Amount A, Amount B and Amount C.

- **Amount A** – A share of residual profit allocated to market jurisdictions using a formulaic approach applied at an MNE group (or business line) level. [10] This new taxing right can apply irrespective of the existence of physical presence, especially for automated digital services. It reflects profits associated with the active and sustained participation of a business in the economy of a market jurisdiction, through activities in, or remotely directed at that jurisdiction, and therefore constitutes the primary response of the unified approach to the tax challenges of the digitalisation of the economy.
- **Amount B** – A fixed remuneration based on the ALP for defined baseline distribution and marketing functions that take place in the market jurisdiction.
- **Amount C** – The return under Amount C covers any additional profit where in-country functions exceed the baseline activity compensated under Amount B. A further aspect of Amount C is the emphasis it gives to the need for improved dispute resolution processes. The scope of Amount C is still being discussed and considered as a critical element in reaching an overall agreement on Pillar One (see Section 5 below).

11. Whilst some overlaps are possible (see Section 3.4 below), each of these three types of taxable profit have a different scope. Further, unlike Amount A, Amounts B and C do not create any new taxing rights. The taxable profits potentially allocable to market jurisdictions under Amounts B and C are based on the existing profit allocation rules (including the reliance on physical presence), and reflect efforts to

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[9] For the purpose of this paper, user/market jurisdictions (henceforth "market jurisdictions") are jurisdictions where an MNE group sells its products or services or, in the case of highly digitalised businesses, provides services to users or solicits and collects data or content contributions from them.

[10] The residual profit used for Amount A will be the result of simplifying conventions agreed on a consensual basis.

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improve the practical application of the ALP. The formula-based approach (with no connection to the ALP) is therefore applied only in the case of Amount A.

12. The following sections describe in more detail the key components of this unified approach, including a number of important pending questions, on which further work will be required to arrive at a political agreement by mid-2020.

3. The New Taxing Right (Amount A)

13. As noted, the primary response to the tax challenges of the digitalisation of the economy is a new taxing right over a portion of residual profits allocable to market jurisdictions. This will be limited to large MNE groups in scope which meet a new nexus test in the market jurisdiction concerned (3.1.), and to the agreed quantum of profit represented by Amount A (3.2.). These parameters need to be designed in a way that is simple, avoids double taxation (3.3.), and can be designed to work alongside the ALP, including as represented by Amounts B and C (3.4.). To clarify the scope and possible impact of Amount A on MNE groups, a decision tree is available in Annex B.

3.1. Scope and nexus

14. This section outlines the scope of Amount A, which will be due only from businesses in scope (3.1.1.) that meet a new nexus test in the market jurisdiction concerned (hereafter, "eligible market jurisdictions") (3.1.2.).

3.1.1. Scope

Policy issue

15. In a digital age, the allocation of taxing rights and taxable profits can no longer be exclusively circumscribed by reference to physical presence. Due to globalisation and the digitalisation of the economy, there are businesses that can develop an active and sustained engagement in a market jurisdiction, beyond the mere conclusion of sales, without necessarily investing in local infrastructure and operations. This means that the profits attributable to the physical operations that a business undertakes in a jurisdiction, in accordance with Articles 5, 7 and 9 of the OECD and UN Model Tax Conventions, may no longer be reflective of its sustained and significant engagement in the market.

16. Amount A seeks to respond to that situation, through the allocation of a portion of the residual profits of a business to market jurisdictions. The amount so allocated is over and above the arm's length return that might be allocable to in-market activities such as baseline marketing and distribution, but is not an additional remuneration in respect of those same in-market activities.[11]

17. This policy issue is of relevance to businesses that can, with or without the benefit of local physical operations, participate in a sustained and significant manner in the economic life of a jurisdiction. Such participation is attributable to the nature of what is being supplied, how it is being supplied and the nature of the active interaction or engagement with market jurisdictions. Accordingly, the policy objective pursued by the new taxing right is most relevant to two broad sets of business.

18. First, it is of relevance to businesses that provide automated and standardised digital services to a large and global customer or user base. These are businesses that, in general, are able to provide digital services remotely to customers in markets using little or no local infrastructure. In these situations, they generally benefit from exploiting powerful customer or user network effects and generate substantial value

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[11] See also paragraph 55 and 56 below.

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from interaction with users and customers. They often benefit from data and content contributions made by users and from the intensive monitoring of users' activities and the exploitation of corresponding data. In some models the customers may interact on an almost continuous basis with the supplier's facilities and services. These characteristics are exhibited more strongly within certain types of digital service provision. However, the ability to develop an active and sustained presence in remote markets through the channels identified above can be considered of general applicability to businesses that provide an automated service on a digital platform.

19. Second, the policy issue outlined above has relevance to other businesses that generate revenues from selling goods or services, whether directly or indirectly, to consumers (i.e. consumer facing businesses). This is a broad set of businesses that includes traditional businesses that have been disrupted to a lesser degree by digitalisation, e.g. businesses that manufacture physical products, sell those products through physical distribution channels and support sales with less sophisticated marketing methods such as television and banner advertising. However, there is an increasing use by these businesses of digital technologies to more heavily interact and engage with their customer base. That could be through building more sustained relationships with individual customers, through more targeted marketing and branding, and through the collection and exploitation of individual customer data. This is particularly true of businesses that are selling connected products and those using online platforms as a principal means of selling and marketing to consumers.

20. The fact that this customer interaction and engagement can be carried out from a remote location means that these businesses are increasingly able to have an active non-physical presence in market jurisdictions[12] through which they substantially improve the value of their products and increase their sales.

Businesses in scope

21. Against this background, the businesses that will fall within scope of the new taxing right under Amount A will be those that fall into the two categories described below.

Automated digital services

22. These services will cover businesses that generate revenue from the provision of automated digital services that are provided on a standardised basis to a large population of customers or users across multiple jurisdictions.[13] This would be expected to include the following non-exhaustive list of business models:

- online search engines;
- social media platforms;
- online intermediation platforms, including the operation of online marketplaces, irrespective of whether used by businesses or consumers;
- digital content streaming;
- online gaming;
- cloud computing services; and
- online advertising services.

[12] This issue is also potentially relevant in situations where the MNE group has a physical taxable presence in the market jurisdiction. This is because existing rules (Articles 5, 7 and 9 of the OECD and UN Models) do not allocate profit to that taxable presence based on the group's profit or on its overall engagement with that market jurisdiction, which can also be carried out from a remote location.

[13] Including revenue associated with the monetisation of data.

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23. Further work will be required on the definition of an automated digital service, especially for business models that deal mostly with other businesses, and on the distinction between such digital service businesses and businesses whose services might be delivered to a customer online but involve a high degree of human intervention and judgement. The latter types of business typically include professional services such as legal, accounting, architectural, engineering and consulting, which do not fall within scope of this definition.

Consumer-facing businesses

24. This would cover businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, i.e. individuals that are purchasing items for personal use and not for commercial or professional purposes.

25. This would bring into the scope of the new taxing right not only businesses that sell goods and services directly to consumers, but also those that sell consumer products indirectly through third-party resellers or intermediaries that perform routine tasks such as minor assembly and packaging.

26. Businesses selling intermediate products and components that are incorporated into a finished product sold to consumers would be out of scope, subject to a possible exception for intermediate products or components that are branded and commonly acquired by consumers for personal use.

27. Finally, the intention is to bring into scope businesses that generate revenue from licensing rights over trademarked consumer products and businesses that generate revenue through licensing a consumer brand (and commercial know-how) such as under a franchise model.

28. For example, the definition of a consumer-facing business would be expected to bring into scope the following non-exhaustive list of businesses:

- personal computing products (e.g. software, home appliances, mobile phones);
- clothes, toiletries, cosmetics, luxury goods;
- branded foods and refreshments;
- franchise models, such as licensing arrangements involving the restaurant and hotel sector; and
- automobiles.

29. Further work will be needed on the definitions of some of the key terms identified above.

Specific considerations

30. Extractive industries and other producers and sellers of raw materials and commodities will not be within the consumer-facing definition, even if those materials and commodities are incorporated further down the supply chain into consumer products. Taxes on profits from the extraction of a nation's natural resources can be considered to be part of the price paid by the exploiting company for those national assets, a price which is properly paid to the resource owner. Extractives and other commodities such as agricultural and forestry products are generally generic goods which are sold, and whose price is determined, on the basis of their inherent characteristics. For example, the sale of sacks of green coffee beans will not be within the scope of the new taxing right, whereas the sale of branded jars of coffee will be.

31. Most of the activities of the financial services sector (which includes insurance activities) take place with commercial customers and will therefore be out of scope. However, there is also a compelling case for the consumer-facing business lines such as retail banks and insurance within financial services businesses to be excluded from scope given the impact of prudential regulation and, for example, bank/insurance licensing requirements that are designed to protect local deposit/policy holders in the market jurisdiction. This typically ensures that residual profits are largely realised in local customer markets

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and therefore justifies that these activities should be excluded from scope. Consideration might, however, be given to whether there are any unregulated elements of the financial services sector or related to the sector which require special consideration, such as digital peer-to-peer lending platforms.

32. The effect of nearly all bilateral tax treaties is to assign exclusive taxing rights over the profits of an enterprise from the operation of ships and aircraft in international traffic to the state of residence of the enterprise. This long-standing practice has its own rationale, and it is therefore considered inappropriate to include airline and shipping businesses in the scope of the new taxing right.

Interaction with other elements of the Amount A design

33. There will be many groups with diverse activities, some of which will meet the definitions above, some of which will not. This may be addressed by the segmentation of those activities into different business lines to which Amount A would be separately applied. Further work will be required to determine what level of segmentation is practicable and verifiable.

34. Even within business lines, sales of a product or service may be made to both consumers and business customers. An example would be a seller of personal computers whose customers include small businesses and consumers. As stated in paragraph 24, if the product is of a type that is commonly sold to consumers it would be expected to fall within the definition of a consumer-facing business.

Thresholds

35. In order to ensure that the compliance and administrative burdens are proportionate to the intended benefits, the new taxing right will operate with a number of thresholds. First it will be limited to MNE groups that meet a certain gross revenue threshold. This threshold could, for instance, be the same as for Country-by-Country (CbC) reporting pursuant to BEPS Action 13 (i.e. MNE groups with gross revenue exceeding EUR750M). This avoids unnecessary compliance costs for smaller businesses and also provides a possible infrastructure for filing and exchange of information. Second, even for those MNE groups that meet the gross revenue threshold a further carve-out will be considered where the total aggregated in-scope revenue is less than a certain threshold. Third, consideration will be given to a carve-out for situations where the total profit to be allocated under the new taxing right would not meet a certain *de minimis* amount.[14] Finally, the effective computation of Amount A (see paragraph 46 below) and application of the new nexus rule (see paragraph 37 below) will involve additional thresholds. An overview of the impact and combination of these multiple thresholds is available in Annex B.

3.1.2. Nexus

36. For MNEs in scope a new nexus rule will be created based on indicators of a significant and sustained engagement with market jurisdictions. The rule will be contained in a standalone rule to limit any unintended spill-over effects on other existing tax or non-tax rules. The implementation and administration of the new nexus rule will be designed so as to eliminate (or limit to a bare minimum) any filing and other tax related obligations arising from the allocation of the new taxing right to multiple market jurisdictions. This will include exploration of simplified reporting and registration-based mechanisms (such as a "one stop shop") and exclusive filing in the ultimate parent jurisdiction (following the approach used for Action 13 CbC reporting).

37. The generation of in-scope revenue in a market jurisdiction over a period of years would be the primary evidence of a significant and sustained engagement. The revenue threshold would be

[14] For example, this might cover the situation of a large, domestically-focused business with a minimal level of foreign income.

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commensurate with the size of a market, with an absolute minimum amount to be determined. The final agreement will include precise figures for the amount of the threshold.

38. For automated digitalised businesses in scope, the revenue threshold will be the only test required to create nexus. This recognises the fact that in a digital age, with scale without mass and unparalleled reliance on intangibles, the supply of automated digital services generally involves the level of active and sustained engagement with customers described above, even when the service is provided remotely.

39. For other in-scope activities, e.g. the sale of tangible goods, the proposal will not create a new nexus if the MNE is merely selling consumer goods into a market jurisdiction without a sustained interaction with the market. This recognises that the cross-border sale of tangible goods into a market jurisdiction does not in itself amount to a significant and sustained engagement in that jurisdiction. Further work will be required to explore the use of possible additional or "plus" factors, such as the existence of a physical presence of the MNE in the market jurisdiction or targeted advertising directed at the market jurisdiction. The overriding objective, in combination with the different thresholds, is to avoid encompassing mere sales and to avoid or minimise additional compliance burdens, especially in situations where an MNE is not already present in a market or has not specifically targeted that market from abroad.

40. The rules will also be designed to avoid spill-over effects on any other (existing) nexus rule so that the new nexus remains exclusively applicable to the new taxing right (and cannot be used as a basis for creating a nexus for other taxes, whether income or non-income taxes, customs duties nor in any other non-tax context).

41. The future work will design clear and administrable rules that will source revenues to market jurisdictions for the purposes of establishing the nexus revenue threshold in, and also for the purposes of allocating profits to, that jurisdiction. This work will take into account the manner in which different automated digital services and consumer-facing businesses operate in market jurisdictions. It is of particular importance to deliver sourcing rules to cover certain digital transactions, for example by sourcing the revenue from online advertising services where the users ("eyeballs") are located and revenue from other in-scope digital services where they are consumed. It will also be necessary to specify how revenues are sourced when products are sold via intermediaries before reaching their ultimate consumer.

3.2. Quantum of Amount A

42. This section outlines the calculation of Amount A, which is largely formula-based and excludes business activities in scope that do not exceed a certain level of profitability (3.2.1.). It also discusses the allocation key that will be used to distribute Amount A among the eligible market jurisdictions (3.2.2.).

3.2.1. The tax base

43. In contrast to the traditional transfer pricing "separate entity" approach, the calculation of Amount A will be based on a measure of profit derived from the consolidated group financial accounts. While MNE groups produce consolidated financial statements under different accounting standards, most of the variations identified between different accounting standards are timing differences which do not affect the aggregate amount of income reported over time. This means that the type of adjustments required to harmonise the use of different financial accounting standards across different jurisdictions are likely to be kept to a minimum and relate only to material items, meaning differences that are significant in amount and duration. It also assists the calculation of a measure of profit on a broadly consistent basis across jurisdictions.

44. Among the different profit level indicators available, the public consultation process and various discussions with governments, taxpayers and advisors, indicate that profit before tax ("PBT") is the preferred profit measure to compute Amount A as, in most cases, it most closely approximates the measure of profits by reference to which corporate income tax is normally levied. It will be applied consistently from

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year to year. To ensure that losses are brought into consideration, these rules will apply to both profits and losses, and will include loss carry-forward rules.[15]

45. Where the out-of-scope revenues of a multinational group are material, segmented accounts may be required to capture only in-scope business segments in the allocation of Amount A profits. In some cases, segmentation among multiple regions and/or in-scope business lines may be required where a taxpayer's profitability varies materially between different business lines or regions. The rationale and technical feasibility of regional segmentation will be further explored for a policy decision to be made on its viability. At the same time, consulted parties have also emphasized that the design of any segmentation rules must balance the need for simplicity and accuracy and take account of compliance burdens. Submissions in the public consultation process also asked for consideration of *de minimis* thresholds as well as the ability for taxpayers to elect into business line segmentation among in scope businesses (e.g. across regions or products).

46. Finally, the calculation of Amount A is based on a formula designed to identify the portion of the residual profits that is to be allocated to eligible market jurisdictions, as Amount A applies only to the portion of profit exceeding a certain level of profitability. As part of this formula, the quantum of Amount A could also be weighted to account for different degrees of digitalisation between in-scope business activities (so-called "digital differentiation"). Further negotiation could explore the level of profitability above which Amount A applies, and the portion of the residual profits that goes to market jurisdictions, taking into consideration the interest of small and large market economies. Further consideration will explore whether the relative portion of the profit allocated to the market under Amount A should be the same across all in-scope businesses or whether, to reflect the different degrees of relevance of the policy rationale, there should be different percentages applied for different businesses. The possibility of providing returns to market jurisdictions based on identified activities performed remotely or for the deemed performance of some activities in those jurisdictions as possible alternatives to a higher allocation of Amount A will also be explored.

3.2.2. The allocation key

47. After determining the quantum of Amount A, it will be necessary to distribute Amount A among the eligible market jurisdictions based on an agreed allocation key. This allocation key will be based on sales of a type that generate nexus (see section 3.1.2. for the discussion on nexus revenue threshold). Specific revenue-sourcing rules to support its application by reference to different business models will need to be developed. For example, for online advertising such rules will, when possible, deem revenue to arise in the jurisdiction where the advertising is viewed rather than the jurisdiction (if different) where the advertising is purchased. Revenue sourcing will also be considered to address sales through independent distributors in order to avoid possible distortions.

3.3. Elimination of double taxation

48. Where profits are now allocated on the basis of the ALP, Amount A is an overlay to that system. As the ALP already allocates the full MNE group profit (which is, thus, already subject to tax), it is essential that there are appropriate mechanisms to eliminate double taxation. Common approaches to addressing international juridical double taxation, in both tax treaties and domestic law, are for one jurisdiction (the residence jurisdiction, where the owner of the income is tax resident) to exempt the income from tax, or to provide a credit against its own tax for the tax paid in the other jurisdiction (the source jurisdiction, where the income is treated as arising). Additionally, to eliminate economic double taxation resulting from transfer pricing adjustments, tax treaties typically oblige the jurisdiction in which the associated enterprise is

[15] The design of the loss rules will explore how to take account of pre Amount A regime losses, as well as losses that arise after the inception of the Amount A taxing right.

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resident to make a corresponding adjustment to the profits it taxes in the hands of that enterprise (provided it agrees with the transfer pricing adjustment in the first jurisdiction).

49. The application of those mechanisms to eliminate double taxation resulting from Amount A is not straightforward, however, as the calculation of Amount A applies to the profits of an MNE group (or business line) as a whole, rather than on an individual entity and individual country basis.

50. In particular, it will not be possible to use a corresponding adjustment approach (similar to the provisions in Article 9(2) of the OECD or UN Model Tax Convention) to eliminate double taxation in all (or many) cases, as Amount A is not premised on there being identifiable transactions between particular group entities.[16] This will also prevent any unintended impact and issues with custom duties applied to imported goods.

51. Further, while it seems possible that existing domestic and treaty mechanisms (i.e. the credit or exemption method) could continue to relieve international juridical double taxation effectively, it will be necessary to determine which jurisdiction will have an obligation to eliminate any resulting double taxation; and, if there is more than one jurisdiction, the quantum of the relief to be provided by each. It is also critical to take into account the fact that Amount A will affect multiple jurisdictions that may not have existing bilateral treaties between them. This, in turn, requires addressing gaps in treaty coverage (as will be explained in Section 6 below) and the identification of the particular member(s) of an MNE group which are to be treated as owning the deemed residual profits corresponding to the profits taxable in market jurisdictions under Amount A.

52. The unified approach will therefore establish approaches to identifying these taxpayer entities in a way that is both administrable and fair.[17] This will involve further work on: approaches to identify the taxpayer entities by reference to measures of profitability; methods for allocating Amount A liabilities between these entities where there is more than one within a group (including the feasibility of pro-rata allocations); and assessing the extent to which identifying the relevant taxpayer in this way would allow existing mechanisms for eliminating double taxation (the credit or exemption method) to continue to operate effectively.

3.4. Interactions and potential for double counting

53. As set out above, Amount A is part of the three-tier profit allocation system that makes up the unified approach. In practice, this means that an MNE group would first apply the ALP-based profit allocation rules (including Amounts B and C) to determine an initial allocation of profit between different entities and hence between jurisdictions. The relevant Amount A of in-scope MNE groups would then be allocated to eligible market jurisdictions as an overlay or partial override to the ALP-based profit allocation rules.

54. It is therefore important to identify any possible interactions between Amounts A, B and C that are not appropriately dealt with by the mechanisms to eliminate double taxation described above (see 3.3 above). These mechanisms to eliminate double taxation are the primary way in which potential interactions between Amounts A, B and C are addressed.

[16] The system of primary and corresponding adjustments under Article 9 is premised on an underlying transaction, which is absent in the Amount A charge. Instead, other methods based on specific deductions or allowances that are not premised on identifiable transactions could be contemplated, such as exemption methods.

[17] One way to achieve this would be to take into account where the profits reallocated under Amount A are recorded in the existing system (or where located under the ALP, before application of Amount A).

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3.4.1. Interactions between Amounts A and B

55. The three-tier profit allocation system may result in an allocation of both Amount A and Amount B to a market jurisdiction. However, given that Amount A is designed to remunerate market jurisdictions with a portion of the relevant residual profits of that MNE group, and Amount B is designed to remunerate a market jurisdiction with a fixed return for baseline distribution and marketing activities, there will be no significant interaction between Amounts A and B.

3.4.2. Interactions between Amounts A and C

56. An important question is whether double counting may arise where both Amount A and Amount C are allocated to a market jurisdiction because the MNE group already has a taxable presence in that jurisdiction. In such a case, it is suggested that instances of double counting might arise if there is an overlap between Amounts A and C. Areas in which possible double counting might need to be considered relate to: (1) marketing intangibles in the local jurisdiction; (2) comparability adjustments under the ALP; and (3) uncommon interpretations of the ALP. While further consideration of these possible instances of double counting will be required, no instances of possible double counting should give rise to double taxation given the application of mechanisms to eliminate double taxation (see 3.3 above).

57. For an MNE group in scope and liable for Amount A to market jurisdictions, the interaction between Amount A and Amount C may occur each time its activities in scope are subject to a transfer pricing re-assessment. For example, a transfer pricing re-assessment would change the profitability of separate entities within the group, which has been used to identify those entities what would have to pay Amount A, and the jurisdictions that will have to give relief from double taxation. Further work will be undertaken to identify the interaction between Amount A and Amount C.

4. The fixed Return for Defined Baseline Distribution and Marketing Activities (Amount B)

58. Amount B aims to standardise the remuneration of distributors (whether constituted as a subsidiary or a traditional permanent establishment) that buy products from related parties for resale and, in doing so, perform defined “baseline marketing and distribution activities”. It proposes a fixed return to distributors that fall within this definition – a fixed return that is based on the ALP (i.e. Amount B would not be optional nor a safe-harbour). Against this backdrop, Amount B would seek to simplify the computation of the return to activities within scope, and reduce disputes and uncertainty about the pricing of certain types of distribution activities. The overall purpose of Amount B is therefore to:

- achieve a greater degree of simplification in the administration of transfer pricing rules for tax administrations and lower compliance costs for taxpayers; and
- enhance tax certainty about the pricing of transactions, which should lead to a reduction of controversies between tax authorities and taxpayers.

59. Ultimately, it is expected that this fixed return model will allow tax administrations and taxpayers to make more efficient use of resources, focusing on high-risk cases with the potential to raise substantial tax revenue.

60. The fixed return a market jurisdiction would receive through Amount B for baseline distribution and marketing activities would deliver a result that is based on the ALP. To that aim, the work will explore how to account for different functionality levels, as well as differentiation in treatment between industries and regions. The design of Amount B will need to ensure the baseline distribution and marketing activities are only remunerated in Amount B and not (again) in Amount C. This is to be achieved by clear definitions of what constitute baselines activities.

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61. The definition of baseline distribution activities will likely include distribution arrangements with routine levels of functionality, no ownership of intangibles and no or limited risks. Defining what entities and activities would qualify could be achieved by using a positive definition based on qualitative and quantitative factors, together with a list of activities and entities that would be out of scope. The transfer pricing distribution regimes of some countries could provide useful guidance.

62. Reaching agreement on the amount of the fixed percentage will require countries to make trade-offs between strict compliance with the arm's length principle and the administrability of Amount B. That is, while the fixed percentage approach may not encapsulate all the facts and circumstances of each individual case, it does have the potential to significantly simplify the determination of the return for the activities within its scope.

63. The expectation is that treaty changes will not be required to implement the Amount B regime, which should simplify its implementation. Rather, as the Amount B regime, as set forth in section 4, is expected to be in accordance with the ALP, existing treaty provisions should suffice to support its adoption.

64. Accordingly, a number of key technical aspects of Amount B will need to be progressed so that member countries of the Inclusive Framework are in an informed position to support its implementation. Key technical matters to be advanced as part of the revised PoW include:

- definition of baseline activities;
- consideration of an appropriate profit level indicator;
- structuring the return as a fixed percentage at an agreed profit level (e.g. the median);
- utilisation of benchmarking studies based on publicly available information to support the amount of the fixed percentage; and
- the degree to which there may need to be a differentiation in treatment between industries and regions in order to remain in broad conformity with the ALP.

5. Tax Certainty: Dispute Prevention and Resolution

65. Securing tax certainty is an essential element of the unified approach and is a fundamental part of the design of Pillar One. This section provides a preliminary analysis of how Pillar One would increase tax certainty (see sections 5.1. and 5.2.). The work will include the exploration of innovative and inclusive processes to provide such tax certainty to taxpayers and tax administrations alike. The detailed features and scope of these new processes will be further developed as intensive work progresses. Work on tax certainty will require exploring a number of possible options, drawing as much as possible on existing models of multilateral processes – and taking into account domestic legal constraints – and ensuring an inclusive and fair process for both developed and developing countries. Agreement on tax certainty is considered to be critical to the overall agreement, noting that the scope of enhanced dispute resolution is a key component of Pillar One.

5.1. A new framework for dispute prevention and resolution for Amount A

66. The prevention of disputes with respect to Amount A will therefore begin with the design of clear and simple rules.

67. Compared with the arm's length principle, the new approach adopts a different method for the allocation of taxing rights, based on a globally agreed formula. While the risk of disputes under that approach can be reduced using mechanical rules based on clearly articulated formulae and detailed guidance, it cannot be eliminated.

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68. It would be impractical (if not impossible) to allow all affected tax administrations to assess and audit an MNE's calculation and allocation of Amount A and to address potential disputes through existing bilateral dispute resolution mechanisms (however much they have already been improved and might be enhanced) because they generally operate after the event. Any dispute between two jurisdictions over Amount A will likely affect the taxation of Amount A in multiple jurisdictions. Resolving such differences under the existing bilateral system would therefore require multiple mutual agreement procedures involving several jurisdictions where the MNE has meaningful activities or sales, an outcome which would be uncoordinated, inefficient and lengthy.

69. To avoid such an outcome, the new approach would be supported by a clear, administrable and binding process for early dispute prevention. Work will be undertaken to fully develop the details of such a process.

70. It should provide early certainty, before tax assessments are made, to prevent disputes from arising. Certainty should be available over all aspects of Amount A, such as whether an MNE is in scope, the correct delineation of business lines, allocation of central costs and tax losses to business lines, whether a nexus exists in a particular jurisdiction, and identification of the relieving jurisdictions for purposes of eliminating double taxation.

71. It is agreed to explore an innovative approach under which tax administrations of the IF would provide early tax certainty for Amount A, for instance through the establishment of representative panels which would carry on a review function and provide tax certainty. This would require work on the process and governance of such panels to ensure appropriate representation of Members and effective, transparent, and inclusive processes.

72. The design of the process would also need to address the challenge of delivering binding agreements by all tax administrations.

73. Tax administrations' resource constraints will be a factor in the design of these new approaches to dispute prevention. On the other hand, synergies from a multilateral process will ensure that the total resources applied are less than would be needed under the existing separate and uncoordinated system. The new process could provide assistance to panel members from tax administrations with resource constraints – for example through a body of experts, which could also provide assistance with practical aspects of the review process. The new approach will consider the role for the tax administration of the ultimate parent entity and how to secure tax certainty in a timely manner, as well as options for preventing disputes where an MNE has not opted in to the early certainty process.

74. Further, the use of standardised administrative measures (e.g. for information reporting, filing of returns and collection of tax) would help to ensure consistent application and would minimise compliance and administration costs. Detailed guidance on the application of Amount A, reinforced by feedback from the new framework for dispute prevention and resolution outlined below, will also play an important role in preventing disputes.

75. Finally, in the event that a dispute might arise that is not already dealt with by the early dispute prevention process described above, appropriate mandatory binding dispute resolution mechanisms will be developed.[18]

5.2. Tax certainty and dispute prevention and resolution for Amounts B and C

76. There is agreement that a new effective and binding dispute prevention and resolution mechanisms is required for amount A as described above in Section 5.1. The core of the work on tax

[18] This will require reaching consensus on such dispute resolution mechanism.

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certainty and dispute prevention and resolution for Amounts B will be to limit disputes by using fixed rates of return on baseline distribution and marketing activities.

77. As noted in section 4 above, under the new approach, the design of Amount B will remunerate the market jurisdiction for routine “baseline” marketing and distribution activities, not for any other activities, and provide for a fixed return. Thus disputes with respect to Amount B while they can still arise, would be limited by the provision of clear and detailed guidance on the scope of Amount B. The work on Amount B will address appropriate dispute resolution mechanisms to the extent they are required.

78. However, there are currently differing positions on the breadth of application of new enhanced dispute resolution mechanisms to other transfer pricing and permanent establishment disputes that will continue to arise. Nevertheless, there is a need to explore innovative approaches that could be used in this regard including exploring the possibility of using the process, or aspects thereof, that may be put in place for providing tax certainty with respect to Amount A. All Inclusive Framework members recognise reaching agreement on the breadth of the application of new enhanced dispute resolution is critical and agree to return to the matter as part of arriving at a consensus-based solution in 2020.

79. As some jurisdictions may have domestic obstacles to the adoption of mandatory binding arbitration, it may be necessary to consider mechanisms that do not present the same issues and that can be adopted by all members of the Inclusive Framework.

80. As with arbitration, the intent of having mandatory and binding dispute resolution procedures is not to rely on them as a main way of resolving disputes. Rather, they are presented chiefly as a backstop, providing a strong incentive for competent authorities to resolve disputes in a timely way under MAP.

81. Enhancing MAP is also an important aspect of the work on tax certainty and dispute prevention and resolution. This could be done by work planned for the 2020 review of BEPS Action 14, as well as other ongoing work to improve the effectiveness and efficiency of multilateral MAP.

82. In addition, specific enhancing measures to be enacted domestically could be explored in the context of Amount C. For example:

- jurisdictions could explore limiting the time during which any adjustments with respect to Amount C could be made; and
- collection could be limited or suspended for the duration of any disputes related to Amount C subject to conditions to be agreed.

6. Implementation and Administration

83. This Outline is presented on a without prejudice basis, including the consideration of the alternative global safe harbour system in section 6.2.

6.1. General

84. Implementing the new approach will require changes to domestic legislation and to tax treaties to remove existing treaty barriers. If different approaches could be envisaged to streamline the implementation of these changes, a new multilateral convention could be negotiated to establish a new multilateral framework for in-scope MNEs to ensure that all jurisdictions can implement the unified approach consistently and at substantially the same time.

85. Unlike the Multilateral Instrument used to implement some BEPS measures, a new multilateral convention would apply between jurisdictions that do not currently have a bilateral treaty, supersede the relevant provisions of existing treaties concluded to eliminate double taxation and contain all the international rules needed to implement the unified approach (scope, nexus, profit allocation, elimination

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of double taxation, and dispute resolution) that are central to achieving tax certainty. This approach would better facilitate the coordinated, consistent and effective implementation that is necessary between multiple jurisdictions and would close the gaps in treaty coverage. The application of the different elements of the package (Amounts A, B and C) in relation to jurisdictions that are not currently covered by a relevant bilateral tax treaty, and the required commitment by non-treaty jurisdictions, are issues that will need to be further explored.

86. The conclusion of a true multilateral convention however requires a strong impetus at the highest political level to achieve acceptance from a critical mass of jurisdictions.[19] The implementation of the new taxing right and the allocation of additional profits to the market jurisdiction should also be contingent on the acceptance of the new dispute prevention and resolution rules described above. Meeting this challenge will be necessary not only to address the challenges arising from the digitalisation of the economy, but also to strengthen and ensure the future sustainability of the existing consensual framework to eliminate double taxation.

87. As noted above, it is also important to build the appropriate framework and infrastructure to support a consistent and efficient administration of the unified approach, including its tax certainty measures. This would be aimed at keeping compliance and administrative costs to a minimum, including in situation involving multiple jurisdictions (Amount A), and ensure that appropriate resources can be made available for the administration of the unified approach.

88. It is recognised that the new taxing right creates a number of novel compliance and implementation requirements (e.g. segmentation). In those circumstances, it may be appropriate to introduce the relevant requirements on a phased basis, and/or possibly adopting a simplified approach to the compliance requirements for a designated initial period through transition rules.

89. It is also expected that any consensus-based agreement must include a commitment by members of the Inclusive Framework to implement this agreement and at the same time to withdraw relevant unilateral actions, and not adopt such unilateral actions in the future. The successful implementation of the unified approach hinges on the withdrawal of such actions because their continued application would challenge the legitimacy of the unified approach and undermine the future stability of the agreed framework.

6.2. Further consideration of alternative global safe harbour system

90. In light of the safe harbour proposal referred to in the *Statement by the OECD/G20 Inclusive Framework on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy*, an alternative approach to Pillar One implementation will be considered. Under this alternative global safe harbour system, an electing MNE group would agree, on a global basis, to be subject to Pillar One. As part of this consideration, the PoW sets forth a work plan by which the IF and relevant working parties give due consideration to the critical design options for such an alternative global safe harbour system. The following is a non-exhaustive list of considerations to be addressed by the IF and relevant working parties:

- Whether there are appropriate potential *scope* modifications to amount A to reflect the nature of this alternative global safe harbour system;
- The need for operating and administration rules for an alternative safe harbour approach;
- Appropriate mechanisms to avoid double taxation in light of a safe harbour approach;

[19] Further work will be required to determine the nature of a critical mass for these purposes, and the consequences of that critical mass not including all jurisdictions.

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- Implications for unilateral measures in the context of the specific safe harbour proposal described in this section; and
- Behavioural implications for taxpayers and jurisdictions.

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Annex A. Programme of Work to Develop a Consensus-Based Solution to Pillar One Issues

1. This Annex sets out the remaining work that needs to be undertaken to further develop the solution described in the *Outline of the Architecture of a Unified Approach on Pillar One*. It is intended to replace the earlier Programme of Work on Pillar One issues adopted by the Inclusive Framework in May 2019.[1]

2. This revised Programme of Work is organised in the following sections: 1. the list of remaining work that needs to be undertaken in order to deliver a consensus-based solution by the end of 2020, 2. the related timeline to meet that deadline, and 3. the allocation of the work to appropriate subsidiary bodies.

1. Remaining work

3. As noted in the *Outline of the Architecture of a Unified Approach on Pillar One*, the remaining technical and policy issues to be resolved under Pillar One have been grouped into 11 work streams, namely:

I. **Scope of Amount A** – The need to address definitional issues for the scope for Amount A (e.g., consumer-facing businesses, automated digital services), develop appropriate revenue and profit thresholds, consider and define carve-outs, examine interactions with other elements of Amount A design and thresholds, and consider whether there are implications for the scope of Amount A of implementing Pillar One on a 'safe harbour' basis[2] (see work stream XI below).

II. **New nexus rules and related treaty considerations for Amount A** – The need to define a new nexus rule based on indicators of significant and sustained engagement with market jurisdictions, which could in some circumstances be unconstrained by physical presence. However, the mere conclusion of sales of tangible goods in the market jurisdiction would not create the new nexus. In addition, this work will consider how to streamline filing obligations and avoid duplication; explore interactions with existing treaty provisions; develop a standalone rule for nexus to avoid unintended spill over effects; and develop revenue-sourcing rules (see work stream V. below).

III. **Tax base determinations** – The need to assess the materiality of differences in financial accounting standards and explore mechanisms to address them; confirm that a profit before tax figure is preferred over other profit level indicators and examine whether potential adjustments to the profit before tax in the consolidated financial accounts are required to be made; consider rules for business line and regional segmentation for the purposes of computing Amount A, explore the materiality and impact of regional differences in profit margins; and assess administrability of using simplification measures to limit the burden of the new rules on tax administrations and taxpayers alike while retaining a principle-based approach. This work will also address issues and options in connection with the design of rules for the treatment of losses under Amount A including the

[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.

[2] i.e. Where an electing MNE group would agree, on a global basis, to be subject to Pillar One.

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calculation and definition of losses and the design of carry-forward rules that govern how losses can be offset against future profits.

IV. **Quantum of Amount A** – The need to conduct economic analysis to inform the decision on the appropriate thresholds for the percentage(s) of profit that represents the deemed residual return, and the design of the formula (e.g. portion of residual profit allocable to market jurisdictions). This work will also explore digital differentiation and the possibility of resulting adjustments to the formulaic computation of Amount A, including different percentages applied to different businesses, and/or providing returns to market jurisdictions based on identified activities performed remotely or for the deemed performance of some activities in those jurisdictions.

V. **Revenue sourcing under Amount A** – The need to design source rules to allocate revenues to specific market/user jurisdictions by identifying principles and objectives as well as considering relevant proxies that could support its application to different business models (e.g. multi-sided business models such as online advertising). This work is relevant for both nexus and profit allocation rules, and will also explore the practical and administrative issues that may arise in establishing and administering revenue sourcing rules, including whether and in what circumstances to look through independent distributors and how to do so.

VI. **Elimination of double taxation under Amount A –** The need to address issues and options in connection with the elimination of double taxation for Amount A such as identification of the taxpayers deemed to own the taxable profit corresponding to Amount A ; the design of new methods (update of existing rules) to eliminate double taxation; and the need for new rules in the context of a new multilateral convention to provide a relief-of-double-taxation mechanism to address gaps in existing bilateral treaty relationships.

VII. **Interactions between Amounts A, B and C and potential risks of double counting** – The need to address issues and options in connection with the interactions between Amounts A, B and C, with a focus on potential double counting issues such as the design of mechanisms to eliminate any double taxation including by adjustment of Amount A. This work will also include the design of Amount A so that there is no impact or influence on other taxes (e.g. Value Added Tax, excise taxes, customs duty, etc.); the design of Amount B so it only remunerates baseline distribution and marketing activities; and identification of any other interactions, including with unrelated articles of bilateral double taxation agreements.

VIII. **Features of Amount B** – The need to address issues and options related to the design features of Amount B such as definition of “base line” distribution activities; determination of the quantum including use of fixed percentage(s); identification of an appropriate profit level indicator; the use of publicly available information for various industries and regions; considering the impact of regional differences in profit margins across regions and industries; the adoption of exemptions; the treatment of multifunctional entities and entities with very low system profits; and implementation issues, including coordination with the current transfer pricing system without giving rise to double taxation or double non-taxation.

IX. **Dispute prevention and resolution for Amount A** – The need to address issues and options in connection with new approaches to enhance tax certainty and to prevent and resolve tax disputes. This will include the development of a new approach on a multilateral basis, to provide early certainty to prevent disputes and to minimise compliance and administration costs as well as measures to timely resolve any disputes that do arise. This approach will be mandatory and binding. The work here may be done in the context of a potential new multilateral convention to address gaps in treaty coverage between multiple jurisdictions, given the multilateral nature of Amount A.

X. **Dispute prevention and resolution for Amounts B and C** – The need to explore issues and options in connection with the development of effective dispute prevention and resolution procedures, such as the design of mandatory binding dispute resolution mechanisms (including mechanisms developed under Amount A) and any necessary enhancements to existing rules on mutual agreement procedures to prevent potential disputes and/or facilitate their resolution.

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XI. **Implementation and administration** – The need to address issues and options in connection with the implementation and administration of the Unified Approach (Amounts A, B and C), such as exploring changes in domestic legislation; exploring feasibility and implications of implementing Pillar One on a 'safe harbour' basis; identifying the required changes to tax treaties and exchange of information mechanisms; the design of a multilateral convention (including the applicability of different elements of the solution (Amounts A, B and C) in relation to jurisdictions that are not currently covered by a relevant bilateral tax treaty) with coordinated entry into force provisions; the identification of relevant unilateral measures; measures to limit compliance and administrative costs and maximise certainty, including in situation involving multiple jurisdictions; and options/procedures to make the new taxing right as simple as possible.

In relation to a 'safe harbour' approach, detailed consideration will be required to assess key impacts and issues of implementing such an approach. These key considerations include estimation of revenue impacts for jurisdictions, feasibility of a system in which some MNE groups elect in and others do not, required operating and administration rules (e.g. process for electing and revoking an election, carry-over of tax attributes from pre-electing years, reorganisations of the MNE group), required treaty and domestic law changes, interactions with dispute prevention and resolution measures, implications for unilateral measures, the likely behavioural implications for taxpayers and jurisdictions, and the design of double taxation relief mechanisms.

2. Timeline

4. This revised programme of work (PoW) invites the Inclusive Framework and its subsidiary bodies to develop solutions to these technical and policy issues along the following timeline:

- First, the Steering Group, drawing on the expertise and inputs from various subsidiary bodies, will continue to work towards reaching an agreement in the Inclusive Framework on **the key policy features of a consensus-based solution to the Pillar One issues by July 2020**.
- Second, the Steering Group and subsidiary bodies will continue to work towards producing **a final report by the end of 2020** that will set out the technical details of the consensus-based solution agreed by the Inclusive Framework.

5. The result is that aspects of the work programme will need to be completed in June 2020, where the related output is necessary to support a decision on the relevance and feasibility of key features of the consensus-based solution to Pillar One. This includes for example the definition of the categories of business activities falling within the scope of the new taxing right (see work stream I. above), and the determination of the appropriate thresholds for the percentage(s) of profit that will be reallocated under the new taxing right (see work stream IV. above). Other aspects of the work programme will instead be completed in November 2020, where the related output is only necessary to support the technical design and implementation of the consensus-based solution. This includes for example identifying changes to tax treaties required to remove barriers to the implementation of the new taxing right (see work stream XI. above).

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3. Organisation

6. The technical expertise needed to deliver the measures envisaged in this revised PoW is largely found within the Inclusive Framework's existing architecture in the following subsidiary bodies of the Committee on Fiscal Affairs:

- Working Parties 1 and 6;
- The Task Force on the Digital Economy (TFDE); and
- Other subsidiary bodies such as the FTA MAP Forum (responsible for implementation of BEPS Action 14) and Working Party 10 (responsible for exchange of information) as well as other bodies including the CBC Reporting Group.

7. Table 1 below identifies the different subsidiary bodies with primary responsibility for each of the work-streams identified. This responsibility includes addressing all the different issues outlined in Section 2 above within the agreed timeline, as well as organising consultations with other relevant subsidiary bodies. Further, given the broad range of issues covered and the challenging timeline, it will be important to ensure for each work stream an effective participation of all members of the Inclusive Framework, including small and developing economies, as well as inputs from relevant external stakeholders (e.g. businesses) with the necessary skills and expertise. Finally, an effective and efficient coordination of the work programme will be essential, including continued guidance to advance and prioritise aspects of the programme of work that are necessary to support a decision on the key features of the consensus-based solution in June 2020. The economic analysis of these features will be of great importance for decision-making. The Steering Group of the Inclusive Framework, with the support of the TFDE, will therefore continue to steer, monitor and coordinate the work and outputs produced by different subsidiary bodies.

Table 1. Assignment of technical work to subsidiary bodies

	References to the Outline of the Architecture of a Unified Approach on Pillar One	Working Party responsible	Meeting dates[3]
Overall co-ordination		TFDE	March to November 2020
I. Scope of Amount A	3.1.1.	WP1/WP6	April to November 2020
II. New Nexus and related treaty considerations for Amount A	3.1.2.	WP1	April to November 2020
III. Tax base determinations for Amount A	3.2.1.	WP6	April to November 2020
IV. Quantum of Amount A	3.2.1.	WP6	April to November 2020
V. Revenue sourcing under Amount A	3.2.2.	WP1/WP6	April to November 2020
VI. Elimination of a double taxation under Amount A	3.3.	WP1/WP6	April to November 2020
VII. Interactions between Amounts A, B and C and potential risks of double counting	3.4.	WP1/WP6	April to November 2020
VIII. Features of Amount B	4.	WP6	April to November 2020
IX. Dispute prevention and resolution for Amount A	5.1.	WP1/FTA MAP Forum	February to November 2020
X. Dispute prevention and resolution for Amounts B and C	5.2.	WP1/FTA MAP Forum	February to November 2020
XI. Implementation and administration	6.	WP1/WP6/WP10	April to November 2020

[3] The first meeting dates of the subsidiary bodies planned so far include: Joint FTA MAP Forum bureau/WP1 extended bureau on February 28, Joint WP1 bureau/WP6 Focus Group on March 30 to April 3, Joint WP1/WP6 on April 20-23.

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Annex B. MNE Groups Impacted by Amount A

1. Turnover Test

Only MNEs the turnover of which exceed EUR [x] are taken into account for Amount A liability

2. Activities Test

Only automated digital services and consumer-facing activities are taken into account for Amount A liability

3. De Minimis Test on In-Scope Revenues

Only the in-scope revenues from aggregated consumer-facing activities and/or automated digital services exceeding EUR [x] are taken into account for Amount A liability

4. Business Lines Profitability Test

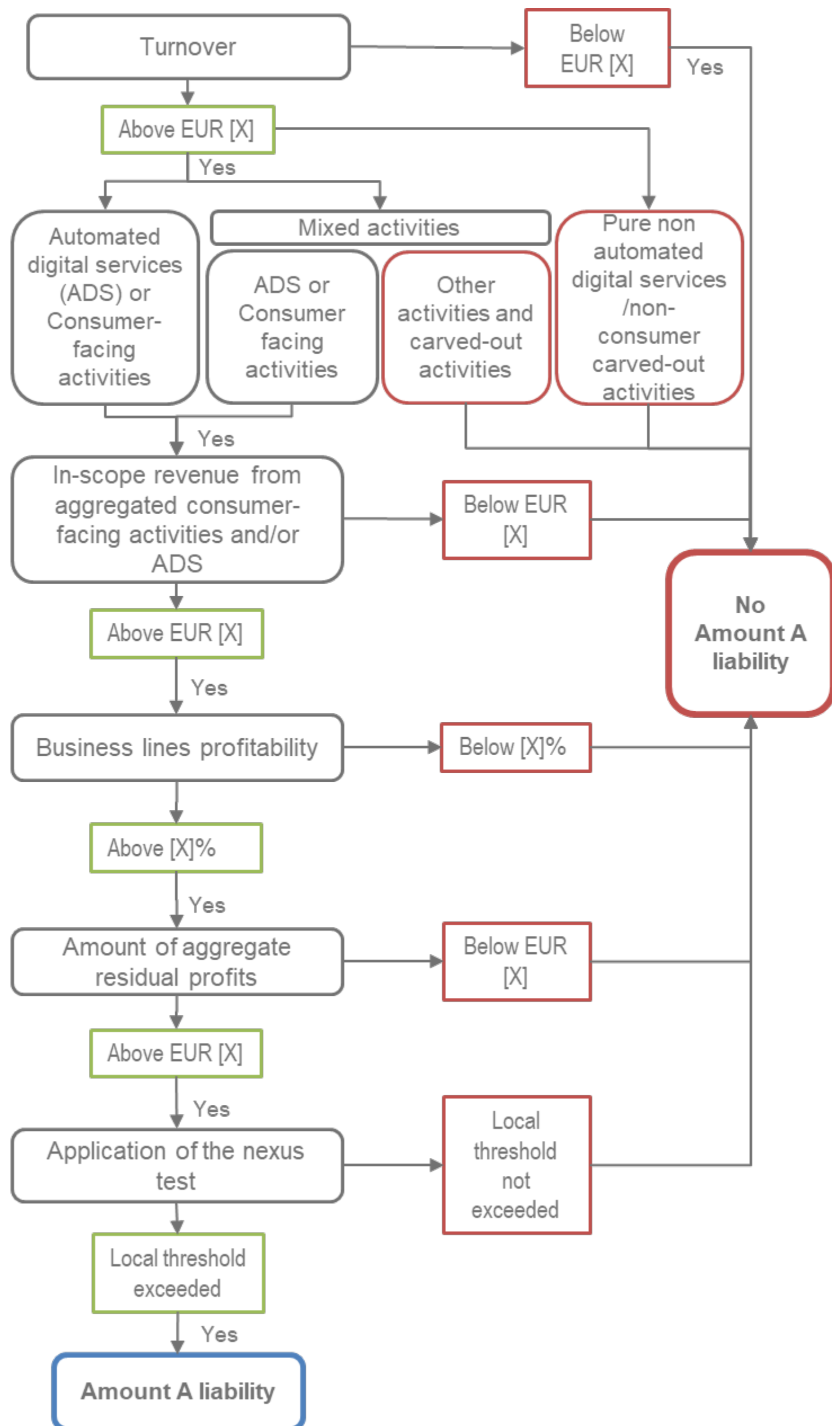
Only the in-scope revenues falling within business lines the profitability of which exceed [X]% are taken into account for Amount A liability

5. De Minimis test on Aggregate Residual Profits

Only if the amount of aggregate deemed residual profits exceeds EUR [x] is Amount A calculated and reallocated

6. Nexus Test in each Market Jurisdiction

Amount A is allocated to market jurisdictions that meet the nexus threshold (local revenue, other factors)



Annex 2. Progress Note on Pillar Two

1. Introduction

1. In January 2019, the Inclusive Framework issued a Policy Note on Addressing the Tax Challenges of the Digitalisation of the Economy.[1] Under this Policy Note, the Inclusive Framework agreed, on a without prejudice basis, to undertake work on the following two pillars:

- Pillar One focuses on the allocation of taxing rights, and seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules.
- Pillar Two (also referred to as the "GloBE" proposal) focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation.

2. The Inclusive Framework issued a Public Consultation Document on 13 February 2019, which sought input from external stakeholders on the specific proposals examined under Pillar One and Pillar Two.[2] The response was robust, with more than 200 written submissions running to over 2,000 pages.[3] Stakeholders had the opportunity to attend in person and express their views at a public consultation held in Paris on 13 and 14 March 2019, which was attended by over 400 representatives from governments, business, civil society and academia.

3. Following this consultation, and in light of the public comments received, the Inclusive Framework agreed on a Programme of Work[4] (PoW) at their meeting in Paris on 28-29 May 2019 based around the two Pillars identified in the Policy Note. This was endorsed by the G20 Finance Ministers and Leaders in June 2019. A public consultation on Pillar Two was held on 9 December 2019, which attracted over 200 participants and resulted in the submission of more than 180 written comments running to over 1,300 pages.

[1] *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, as approved by the Inclusive Framework on BEPS on 23 January 2019, OECD 2019.

[2] Public Consultation Document, *Addressing the Tax Challenges of the Digitalisation of the Economy*, 13 February – 6 March 2019.

[3] All written submissions made to the Public Consultation Document are available at this link.

[4] *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, 28 May 2019, (PoW).

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2. Status of the work and next steps

4. Following the PoW agreed by the Inclusive Framework in May constructive discussion has been conducted under Pillar Two. Unlike in the context of Pillar One where there were competing proposals that needed to be brought together in a "Unified Approach", the individual components under Pillar Two were already identified in the PoW, noting of course that with respect to a number of the key elements of Pillar Two, various design options remain under discussion. Some countries have suggested to improve further the policy design of Pillar Two to ensure its focus on remaining BEPS issues and take the view that a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax would go beyond the policy objective of Pillar Two. These countries further suggested that exploration of improvements in the policy design would therefore be welcomed.

5. The technical tasks regarding Pillar Two are being advanced by the relevant Working Parties which co-ordinate closely. Working Party 11 held a joint session with the Working Party 1 Extended Bureau on 10 December 2019 to ensure full alignment and allow for a common debrief on the public consultation held the previous day. Given the mandate in the PoW to explore simplifications that could reduce compliance costs to businesses, and in particular the use of financial accounts, Working Party 11 has set up a special subgroup on financial accounts. This subgroup brings together experts with tax technical as well as financial accounting expertise.

6. Significant work on key issues is advancing at a fast pace with good technical progress on many aspects of the GloBE proposal but significant work still remains. The Inclusive Framework is aware of the implications that the timelines of the project have imposed on all stakeholders, is very appreciative of all the input received so far and looks forward to continued close engagement.

7. Work will continue with a series of meetings already planned. The remainder of this note provides a short summary of each of the components of the GloBE proposal and a very brief update on the status of the work on some of the related key issues.

2.1. Income inclusion rule

8. The basic approach taken by the income inclusion rules will be familiar to many taxpayers and tax administrations as it draws on the design of controlled foreign company (CFC) rules. The income inclusion rule would operate as a minimum tax by requiring a shareholder in a corporation to bring into account a proportionate share of the income of that corporation if that income was not subject to an effective rate of tax above a minimum rate. It would ensure that the income of the MNE group is subject to tax at a minimum rate thereby reducing the incentive to allocate income for tax reasons to low taxed entities. Its effect would be to protect the tax base of the parent jurisdiction as well as other jurisdictions where the group operates by reducing the incentive to put in place intra-group financing, such as thick capitalisation, or other planning structures that shift profit to those group entities that are taxed at an effective rate of tax below the minimum rate.

9. The PoW provides that the inclusion rule would operate as a top-up tax to a minimum rate calculated as a fixed percentage. The actual rate to be applied under the GloBE proposal has not yet been discussed by the Inclusive Framework. Other elements of the rule remain subject to further discussion with different design options under consideration.

10. Extensive work is underway around the use of financial accounts as a basis for the income determination as well as different mechanisms to address temporary differences between tax and financial accounting. The objective would be to limit adjustments for permanent differences to reduce complexity and compliance costs, with benefits for both taxpayers and tax administrations. The work will explore the use of principle-based criteria, including materiality and commonality, to identify the relevant permanent differences. There are detailed discussions around a range of important technical issues which were also

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the subject of the December public consultation and where valuable input was provided by stakeholders both at the consultation and in written comments.

11. On the question of blending (i.e., the ability to combine low-tax and high-tax income in determining the effective tax rate) the technical work carried out so far, supported by the public consultation and the written comments submitted by stakeholders, has helped to identify the policy choices that remain under consideration as well as design and compliance challenges of different approaches. It also highlights that there are a range of different elements to the GloBE proposal of which the type of blending is an important dimension but not the only one.

12. Another focus of the work and a key design issue for Pillar Two is the question of carve-outs. Different options are under consideration. The PoW noted that carve-outs for regimes compliant with the standards of BEPS Action 5 on harmful tax practices and other substance based carve-outs would undermine the policy intent and effectiveness of the GloBE proposal. However, some jurisdictions have stressed the importance of including substance carve-outs because, in their view, such carve-outs are necessary to ensure that the focus of Pillar Two is on remaining BEPS issues.

13. Some of the design features under discussion will also be relevant for other elements of the GloBE proposal. For example, the discussions on carve-outs[5] and the use of financial accounts to determine the tax base are also relevant for the undertaxed payments rule.

2.2. Switch-over rule

14. The GloBE proposal should apply equally to foreign branches and foreign subsidiaries that are taxed at an effective rate of tax below the minimum rate. The switch-over rule is a mechanism designed to ensure that the income inclusion rule applies to foreign branches exempt under double tax treaties. It would only apply where countries have committed to use the exemption method in their tax treaties. For example, in the case of profits attributable to exempt foreign branches, or that are derived from exempt foreign immovable property, the income inclusion rule could be achieved through a switch-over rule that would turn off the benefit of an exemption for income of a branch, or income derived from foreign immovable property, otherwise provided by a tax treaty and replace it with the credit method where that income was subject to a low effective rate of tax in the foreign jurisdiction.

15. A simple switch-over rule is being developed to facilitate implementation of the income inclusion rule, which will need to consider the final design of the income inclusion rule to ensure consistency in scope.

2.3. Undertaxed payments rule

16. While the income inclusion rule taxes the parent on the low-tax income of a subsidiary, the undertaxed payments rule operates by denying a deduction or making an equivalent adjustment in respect of intra-group payments. The PoW notes that the undertaxed payments rule should be designed to be effective in achieving its stated objectives; be compatible and co-ordinated with other rules; avoid double taxation and taxation in excess of economic profit; minimise compliance and administration costs; and explore the possible use and effect of carve-outs, including those considered in the context of the income inclusion rule.

17. A number of proposals for the design of the undertaxed payments rule have been considered by both the Steering Group and Working Party 11 which has allowed for these groups to refine and better target the rule. These proposals have been designed to limit complexity, compliance and administration costs and the risk of over-taxation.

[5] Cf. PoW, page 33.

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2.4. Subject to tax rule

18. The PoW also includes consideration of a subject to tax rule which could work by subjecting a payment to withholding or other taxes at source and denying treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate.

19. The relevant Working Parties are exploring options and issues in connection with the design of a simple and targeted rule to address the most significant risks from a BEPS perspective. This rule, which is still under discussion, could be based on existing provisions in the Commentary to the OECD Model Convention on Income and on Capital. Further consideration will be given to the scope of the payments covered, the design of the minimum tax rate test, the extent of the adjustment required, the use of a *de minimis* threshold and the role of the subject to tax rule vis a vis the undertaxed payment rule. The PoW also contemplates the exploration of the application of a subject to tax rule to unrelated parties as regards Articles 11 and 12 of the OECD Model Convention.

2.5. Rule co-ordination, simplification, thresholds and compatibility with international obligations

20. There is ongoing work on all aspects of co-ordination, simplification and the compatibility with international obligations such as non-discrimination[6]. This work will address the priority in which the rules would be applied and how they interact with other rules (including existing BEPS measures) in the broader international framework with a view to minimising the risk of double taxation, including simplification measures that would further reduce compliance costs. There are also ongoing work-streams looking into possible thresholds (such as the EUR 750 million revenue threshold used for country-by-country reporting) and carve-outs that would restrict the application of the rules under the GloBE proposal.

[6] Including, where appropriate, taking into account the implications of EU/EEA law.

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