

# OECD presses on with the finalisation of Pillar One of BEPS 2.0

17 February 2023  
Issue 2

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## In brief

The Organisation for Economic Co-operation and Development (OECD) has achieved significant progress in developing the two-pillar solution under Base Erosion and Profit Shifting (BEPS) 2.0. For Pillar One, the OECD has conducted a series of public consultations in 2022. This News Flash provides an overview of the Pillar One public consultation documents released by the OECD since late May 2022<sup>1&2</sup>:

- (1) tax certainty framework for Amount A and tax certainty for issues related to Amount A;
- (2) progress report on the administration and tax certainty aspects of Amount A;
- (3) progress report on the operative provisions of Amount A;
- (4) Amount B; and
- (5) draft multilateral convention (MLC) provisions on digital services taxes (DSTs) and other relevant similar measures (collectively 'unilateral measures').

The public consultation documents represent the work of the OECD Secretariat and do not reflect the final views of the OECD/G20 Inclusive Framework on BEPS (IF). For a more detailed discussion of these documents, please refer to the *PwC Global Tax Policy Alerts*<sup>3</sup>.

The work on both Amount A and Amount B is planned to be completed by mid-2023.

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## In detail

### Tax certainty for Amount A

On 27 May 2022, the OECD released the public consultation documents on (1) the tax certainty framework for Amount A and (2) the tax certainty for issues related to Amount A.

#### Tax certainty framework for Amount A

The framework is designed to provide multinational enterprise (MNE) groups with certainty over all aspects of Amount A and includes the following elements:

- (1) a scope certainty review, which provides an out-of-scope MNE group with certainty that it is not in-scope of rules for Amount A for a period;
- (2) an advance certainty review, which provides certainty over an MNE group's methodology for applying specific aspects of Amount A for a number of future periods; and

- (3) a comprehensive certainty review, which provides an in-scope MNE group with binding multilateral certainty over its application of all aspects of Amount A for a period that has ended, building on the outcomes of any advance certainty applicable for the period.

All three of these elements are supported by a binding process to resolve any disagreements that arise.

### **Tax certainty for issues related to Amount A**

The consultation document contains draft provisions which set out a mandatory and binding mechanism to resolve transfer pricing and permanent establishment profit attribution disputes that competent authorities are unable to resolve through the mutual agreement procedure.

### **Progress report on the administration and tax certainty aspects of Amount A**

The OECD released the progress report on the administration and tax certainty aspects of Amount A on 6 October 2022. In addition to updated tax certainty-related provisions, the progress report includes the rules on the administration of Amount A which are released for public consultation for the first time. It sets out the detailed procedures of how in-scope MNE groups will comply with the rules for Amount A, from the filing of the relevant information to payment of tax and access to timely relief from double taxation.

**Our observations:** The final design of the administration framework and tax certainty framework for Amount A remains to be settled. However, it is clear that both tax administrations and in-scope MNE groups will need to commit significant resources to ensure that there are adequate personnel with the appropriate skills and knowledge to carry out these provisions effectively.

### **Progress report on the operative provisions of Amount A**

On 11 July 2022, the OECD released the progress report on Amount A, which includes a consolidated version of the operative provisions on Amount A (presented in the form of domestic model rules). In addition to updates to rules that have been previously released for public consultation, the progress report sets out the following proposed rules for the first time:

#### **(1) Marketing and distribution profits safe harbour (MDSH)**

The MDSH reduces (and possibly eliminates) the allocation of Amount A for market jurisdictions that already have existing taxing rights over a group's residual profits. The MDSH relies on certain concepts and measures adopted in the mechanism for the elimination of double taxation under Amount A (which is further discussed below). This includes a formula to determine the amount of the reduction for each market jurisdiction and quantitative criteria to identify residual profits already taxed in a market jurisdiction such as a return on depreciation and payroll (RoDP). Several aspects of the rule design, including specific metrics to identify residual profits in a market jurisdiction, the portion of those residual profits that will offset (and reduce) Amount A allocations, and the interaction of this adjustment with the elimination of double taxation mechanism are still under development.

**Our observations:** The RoDP metric for the MDSH formula has led to concern that this metric may not accurately reflect all costs. The progress report notes that work is ongoing to explore fallback metrics for the purposes of the MDSH to address concerns that a pure RoDP approach based on the contemplated thresholds could result in inappropriate outcomes for routine activities with a low payroll and asset base, e.g. routine distributors.

#### **(2) Elimination of double taxation under Amount A**

The obligation to relieve double taxation is allocated among 'relieving jurisdictions' (as defined) using a quantitative approach that stratifies the jurisdictions into tiers based on an in-scope MNE group's profitability (measured by reference to RoDP). The intent of the rules to identify relieving jurisdictions and allocate the obligation of double tax relief for Amount A among those jurisdictions is to have that obligation borne by jurisdictions where the MNE group earns residual profits. The mechanism to relieve double taxation adopts a 'hybrid waterfall' approach under which double taxation would first be relieved by jurisdictions identified in the highest profit tiers, and then (if needed) to lower tier jurisdictions in sequential order.

**Our observations:** Based on the tiered approach, it is likely that the burden of double tax relief will be concentrated among investment hub jurisdictions that earn profits attributable to intangibles and risk.

## Amount B

On 8 December 2022, the OECD released a public consultation document that sets out the main design elements of Amount B. The document aims to standardise the remuneration of related party distributors that perform baseline marketing and distribution activities and seeks input on the main design elements of Amount B, the first two of which form the main part of the consultation: (1) scope; (2) pricing methodology; (3) documentation requirements; and (4) tax certainty.

### Scope

Subject to certain exclusions, the consultation document suggests that Amount B should apply to the following intra-group distribution activities:

- (1) buy-sell arrangements where the distributor purchases goods from associated enterprises resident in other jurisdictions for wholesale distribution to unrelated parties primarily in its local market; and
- (2) sales agency and commissionaire arrangements where the distributor contributes to the wholesale distribution of goods for a related party, subject to whether the distributor exhibits certain economically relevant characteristics subject to the scoping criteria set forth in the consultation document (although this category is still under consideration).

When a transaction is of either category, one still needs to review whether the prescribed scoping criteria are met. The consultation document sets out about a dozen conditions relevant to the scoping criteria, such as the necessity of a written contract, a requirement that the distributor must distribute primarily in its market of residence, and limitations on the distributor's return.

### Pricing methodology

The Amount B pricing methodology is currently based on the Transactional Net Margin Method (TNMM). The consultation document suggests that the TNMM approach could be complemented with an econometric analysis, the latter of which aims to identify macroeconomic and firm-level factors that affect profitability, e.g. geographical region, country-level gross domestic product (i.e. GDP) indicators, asset intensity and operating expenses intensity.

The IF is considering two exemptions to Amount B. The first is whether the Amount B pricing methodology should not be applied when local market comparables are available to price the transaction. The second exemption under consideration would apply if a method other than the TNMM is the most appropriate method in particular cases.

**Our observations:** The technical work on Amount B remains ongoing. While the consultation document makes clear that the IF is still grappling with finding a balance between reliability and administrability in the design of these rules, notable progress has been made to date in developing a broad architectural framework for the Amount B pricing methodology. Taxpayers should model the impact of these rules and engage with government and business organisations to achieve more simplicity and manageability in the final set of rules.

## Draft MLC provisions on unilateral measures

The draft MLC provisions set out in the consultation document focus on unilateral measures and they reflect the commitments to the removal of all existing unilateral measures and the standstill of such future measures. In particular, the consultation document contains two draft articles: one on the removal of existing unilateral measures, and another provision eliminating Amount A allocations for parties imposing unilateral measures.

There will be an Annex that will include a definitive list of existing unilateral measures that meet the definition of a 'DST or relevant similar measure'. However, this list has yet to be agreed upon and is not part of the consultation.

In general, a measure will be considered a 'DST or relevant similar measure' if it satisfies all of the following three criteria:

- (1) The measure is determined primarily by reference to the location of customers or users, or other similar market-based criteria;
- (2) The measure is (de jure or de facto) ring-fenced to non-residents or entities primarily owned by non-residents;
- (3) The measure is not treated as an income tax under the domestic law, or is otherwise outside the scope of tax treaties other than the MLC for Amount A.

Unilateral measures would not include, among others, (i) value-added taxes, (ii) transaction taxes, (iii) withholding taxes that are treated as covered taxes under tax treaties, or (iv) rules addressing abuse of existing tax standards. However, these measures may still impact the allocation of Amount A, such as through the operation of the MDSH or the elimination tax base.

**Our observations:** The consultation document notes that consideration will be given to the form of commitment to the standstill of future unilateral measures and their treatment under Amount A. The consultation document also identifies several open issues, e.g. whether it should be a political commitment or a legal obligation, and whether a jurisdiction should be fully denied its Amount A allocations if it continues to impose unilateral measures.

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## Endnotes

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1. The Pillar One public consultation documents released by the OECD since late May 2022 can be accessed via these links:  
<https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-tax-certainty-framework.pdf>  
<https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-tax-certainty-issues.pdf>  
<https://www.oecd.org/tax/beps/progress-report-on-amount-a-of-pillar-one-july-2022.pdf>  
<https://www.oecd.org/tax/beps/progress-report-administration-tax-certainty-aspects-of-amount-a-pillar-one-october-2022.pdf>  
<https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-b-2022.pdf>  
<https://www.oecd.org/tax/beps/public-consultation-document-draft-mlc-provisions-on-dsts-and-other-relevant-similar-measures.pdf>
2. For a discussion of other documents released by the OECD on Pillar One and Pillar Two, please refer to our news flashes which can be accessed via this link:  
<https://www.pwccn.com/en/services/tax/international-tax/oecd-beps.html>
3. The *PwC Global Tax Policy Alerts* can be accessed via these links:  
<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-launches-consultation-on-pillar-one-amount-a-tax-certainty.pdf>  
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<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-announces-pillar-one-unilateral-measures-consultation.pdf>

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## Let's talk

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- Shui Jie web portal - <https://shuijie.pwconsultantssz.com>

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