

ASIA PACIFIC REGIONAL TAX CONFERENCE

“GLOBALISATION OF TAX RULES IN A DE-GLOBALISING WORLD”

**Marina Bay Sands Hotel
August 16-17, 2023**



Pillar One Panel

Point of view on the future of market-based taxation for digital
business models

Speakers



Matt Andrew (New Zealand)
Asia Pacific Tax Policy Leader
at Ernst & Young Group Ltd
(Moderator)



Michael Nixon
Senior Advisor
Centre for Tax Policy and Administration
OECD



Paulson Tseng
PwC
Taiwan



Pei San Ng
International, Investigation and
Indirect Taxes
Inland Revenue Authority of
Singapore



Lisa Zheng
Senior Director
Proctor and Gamble



Agenda

1. Pillar One Progress
2. Amount A
3. Amount B
4. Final Thoughts



Pillar One Progress

Building blocks of Pillar One

- ▶ A new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group

Amount A

Scope

Nexus

Revenue sourcing

Tax base determination

Profit allocation

Elimination of double taxation

- ▶ A fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the arm's length principle

Amount B

Scope

Quantum

- ▶ Processes to improve tax certainty through effective dispute prevention and resolution mechanisms

Tax certainty

Dispute prevention and resolution for Amount A

Dispute prevention and resolution beyond Amount A

Implementation and administration



Amount A

Update on what is happening in Amount A?

Previous Amount A Public consultation documents

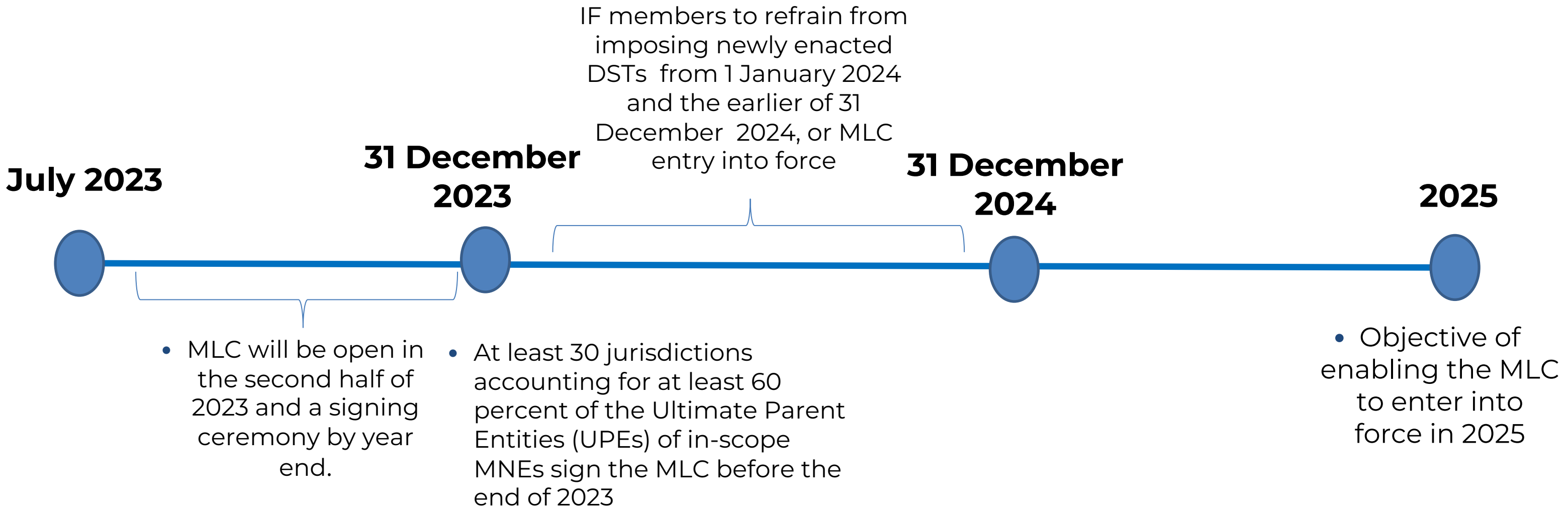
- Draft Model Rules for Nexus and Revenue Sourcing – 4 February 2022
- Draft Model Rules for Tax Base Determinations – 18 April 2022
- Draft Model Rules for Domestic Legislation on Scope – 4 April 2022
- Extractives Exclusion – 14 April 2022
- Regulated Financial Services Exclusion – 6 May 2022
- A Tax Certainty Framework for Amount A – 27 May 2022
- Tax certainty for issues relating to Amount A – 27 May 2022
- Progress Report on the Administration and Tax Certainty Aspects of Amount A of Pillar One - 4 October 2022
- Pillar One – Amount A: Draft Multilateral Convention Provisions on DSTs and other Relevant Measures – 20 December 2022
- Progress Report on Amount A of Pillar One – 11 July 2022

Statement on the Outcome of the Two Pillars – 11 July 2023

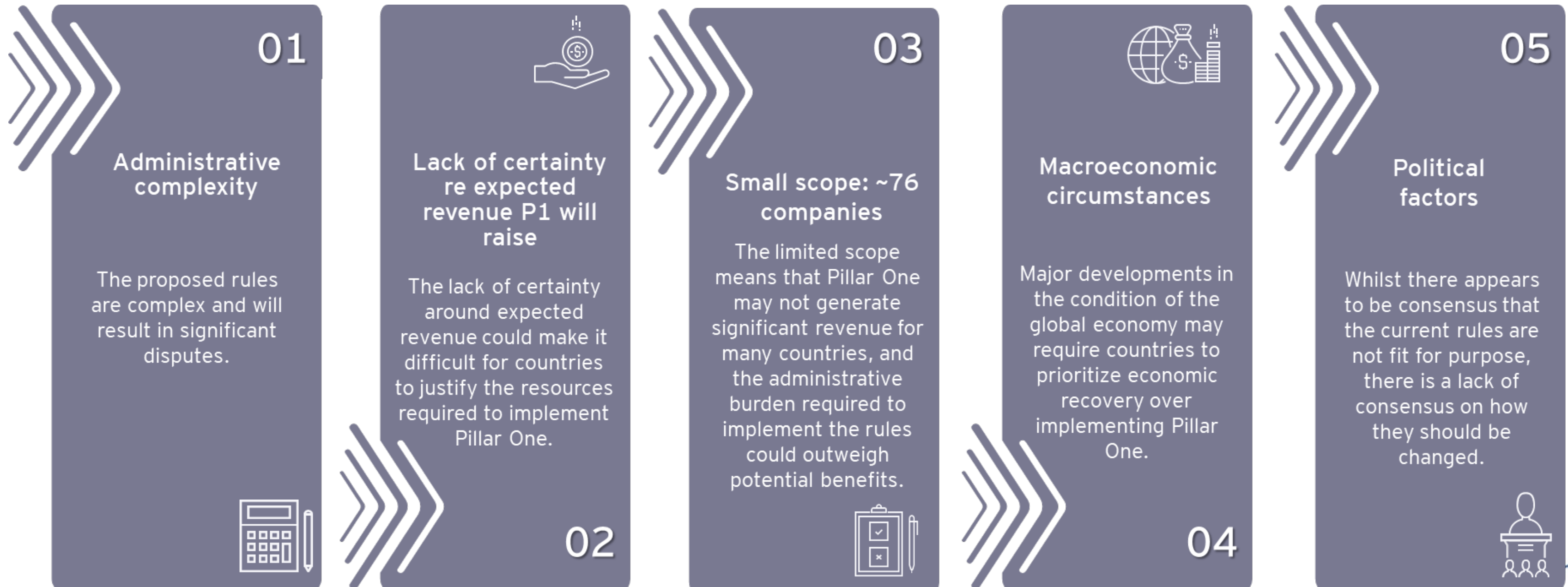
- A few jurisdictions have expressed concerns with some specific items in the MLC.
- The MLC will be opened in the second half of 2023 and a signing ceremony will be organised by year end, with the objective of enabling the MLC to enter into force in 2025
- If at least 30 jurisdictions accounting for at least 60 percent of the Ultimate Parent Entities (UPEs) of in-scope MNEs sign the MLC before the end of 2023, then members of the Inclusive Framework agree to refrain from imposing newly enacted DSTs on any company between 1 January 2024 and the earlier of 31 December 2024, or the entry into force of the MLC.
- Assuming sufficient progress has been made by that date towards the entry into force of the MLC, members of the Inclusive Framework may agree to extend this commitment to the earlier of 31 December 2025, or the entry into force of the MLC.



Amount A depends on a critical mass of countries signing the MLC by the end of 2023



A range of factors are driving pessimism around the implementation timeline



But the cat is now out of the bag: the world expects the tax system to change

“The allocation of taxing rights and taxable profits can no longer be exclusively circumscribed by reference to physical presence.”

Report on the Pillar One Blueprint, OECD, 2020.

In our view, the existing system does not provide a good basis for taxation... Closing loopholes generally increases complexity, and is unlikely to generate a more sensible and stable system. Rather, **fundamental reform is required, and the tax base should be based on relatively immobile factors, either where shareholders are located or where consumers are located.**

Implications of Digitalization for International Corporate Tax, International Monetary Fund

“Whether Amount A was made necessary by something special about the world of big tech or whether big tech was simply the even which meant existing shortcomings could no longer be ignored probably no longer matters...”

“... we can be fairly sure what the future of international tax looks like. Even if Pillar One does not get us there, it certainly marks the start of the journey.”

“One can be confident about this because the approach now has the imprimatur of so many countries.”

Building on the Rubble of Pillar One, Graeme S. Cooper, Bulletin for International Taxation, November / December 2021..

“... French Economy and Finance Minister Bruno Le Maire called for a “European solution”, fearing an international agreement may not be reached.

“We’ll call for the situation on pillar one to be unblocked, but the chances of success are slim,” said Le Maire at a Paris press conference on Monday, February 20.

“Today, things are blocked, notably by the United States, Saudi Arabia and India,” he explained. **“This calls for a digital tax to be extended to a European level as soon as possible.”**

International Tax Review, 23 February 2023.

The EU has also reserved part of the (assumed) Amount A revenues for the EU budget, so there will be a funding gap. Member States and Parliament are already concerned about this, and negotiation on this budget gap will start over (European) summer.



If Pillar One fails to reach a critical mass of ratifications, what comes next?

Unilateral

Digital Services Taxes (DSTs)

- ▶ DSTs were intended to be foregone if agreement was reached on Pillar One, but with Pillar One in doubt, we expect them to be of increased importance.
- ▶ DSTs usually take the form of an excise tax imposed on gross income rather than net income. They are not usually creditable and will effectively lead to double taxation.
- ▶ As of January 2023, Austria, France, Hungary, Italy, Poland, Portugal, Spain, Turkey, and the UK had implemented a DST; while Belgium, the Czech Republic, and Slovakia have published proposals to enact one and Latvia, Norway, and Slovenia had either officially announced or shown intentions to implement such a tax. The proposed and implemented DSTs differ significantly in their scope and structure.

VAT or GST Solutions

- ▶ New requirements for foreign vendors to register and account for consumption tax. This type of tax has been very successful in many Asian Pacific jurisdictions (such as Singapore, Australia and New Zealand).

New nexus rules and digital PEs

- ▶ India is implementing a “significant economic presence” concept which results in the creation of a PE when unorthodox thresholds are met, aimed at, but not exclusive to, digital services.
- ▶ Other jurisdictions are already seeking to apply Pillar One concepts on audit in various jurisdictions, raising concerns that some may “go-it-alone” unilaterally.

Other measures (scenario in which Amount A is agreed and implemented)

- ▶ Denmark - considering a revenue based mandatory contribution by streaming companies to a Danish film fund administered by the tax administration
- ▶ Belgium - considering mandatory contributions by high-bandwidth service providers to telecommunications companies

Multilateral

Alternative multilateral approaches

- ▶ The UN Tax Committee proposed inserting a new article, article 12B, into the UN Model, which uses a withholding tax mechanism to have the country of the customer tax the “qualified profits from automated digital services” (subject to a formula).
- ▶ The rule would also effectively represent a move towards formulary apportionment, but would be negotiated into tax treaties on a bilateral basis.
- ▶ If Pillar One is abandoned, and the UN model preferred, there are other possibilities for implementation e.g. via a multilateral convention.

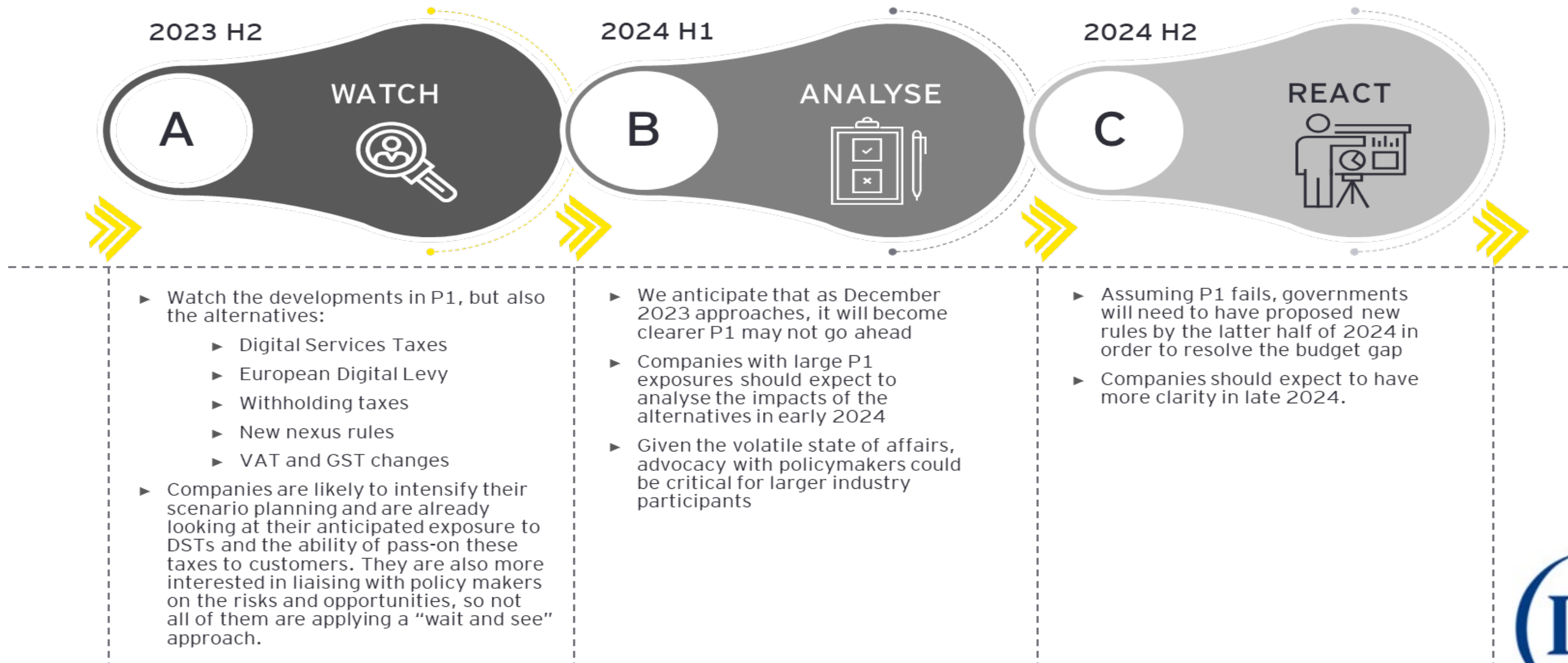
Regional or sub-regional solutions

- ▶ Many European countries have already implemented DSTs, but other European collaboration is possible, including:
 - ▶ The EU Digital Levy, which was supposed to be tabled in June 2021 and introduced at the latest by 1 January 2023. However, the measure was put ‘on hold’ until the final details of Pillar One are completed and agreed upon. It would be a very low rate, but broad base, and could co-exist with Amount A
 - ▶ An alternative which builds on the model developed under Pillar One, to apply a variation of the Pillar One rules on a pan-European basis.
- ▶ EU may also consider additional proposals like the ones put forward by the previous Commission in 2018 (Significant digital presence, interim tax on certain revenue from digital activities which are not currently taxed)



Next steps – Message to In-scope Multinational Groups

Even if the rules are not yet agreed, inaction is no longer an option for policymakers. MNES should consider:



Amount B

Statement on the Outcome of the Two Pillars – 11 July 2023: Amount B

| 1

This document sets out the Outcome Statement approved by [138 members](#) of the OECD/G20 Inclusive Framework on BEPS as of 11 July 2023.

OECD/G20 Base Erosion and Profit Shifting Project

Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy

11 July 2023

Public consultation document to be completed by 1 September 2023 on matters including:

- Ensuring an appropriate balance between a quantitative and qualitative approach in identifying baseline distribution activities
- The appropriateness of:
 - a) the pricing framework, including in light of the final agreement on scope;
 - b) the application of the framework to the wholesale distribution of digital goods;
 - c) country uplifts within geographic markets; and
 - d) the criteria to apply Amount B utilising a local database in certain jurisdictions
- The Inclusive Framework will approve and publish a final Amount B report, content from which will be incorporated into the OECD Transfer Pricing Guidelines by [January 2024](#) with due consideration given to the needs of low capacity jurisdictions



Amount B Public Consultation Document - Scope

Two Alternatives

The two alternatives to scope that are presented in the document, which broadly represent the current positions of jurisdictions when considering these issues:

- “Alternative A”, which does not require a separate qualitative scoping criterion to identify and exclude non-baseline contributions, and
- “Alternative B”, which does require a separate qualitative scoping criterion to identify and exclude non-baseline contributions (in scoping criterion 9.a).



Amount B Public Consultation Document - Scope

Basic elements of scope

- ▶ Buy-sell arrangements for wholesale distribution primarily in its local market
- ▶ Sales agency and commissionaire arrangements where the tested party contributes to the wholesale distribution for a related party and sells to unrelated parties

Qualitative criteria (8.a)

For a qualifying transaction to be in-scope of the simplified and streamlined approach:

- The qualifying transaction must exhibit economically relevant characteristics that mean it can be reliably priced using a one-sided transfer pricing method, with the distributor, sales agent or commissionaire being the tested party.
- The tested party in the qualifying transaction must not incur annual operating expenses lower than 3% and greater than [50%] [30%] of its annual net sales.

For qualifying transactions that do not fall out of scope of the simplified and streamlined approach under paragraph, a qualifying transaction will nevertheless be out of scope if:

- [The tested party makes non-baseline contributions to the transaction of a manner described in section 2.3.3; or]*
- The qualifying transaction involves the distribution of services or the marketing, trading, or distribution of commodities; or
- The tested party carries out non-distribution activities in addition to the qualifying transaction, unless the qualifying transaction can be adequately evaluated on a separate basis, can be reliably priced separately from the non-distribution activities, and meets the administrative guardrail in Section 2.3.5.



Amount B Public Consultation Document - Scope

Quantitative criteria (8.b)

After the application of scoping criterion 8.a, scoping criterion 8.b acts to exclude qualifying transactions from the scope of the simplified and streamlined approach using quantitative filters.

These quantitative filters provide a simplified mechanism for the assessment of whether a tested party is in scope.¹*[Since a qualitative approach is applied to identify, evaluate, and possibly remove from scope distributors that make “non-baseline” contributions, the upper bound serves to remove from scope only those distributors with levels of operating expenses that may indicate anomalous or outlier results.] [The upper bound acts as a proxy to exclude qualifying transactions from scope where the ratio of operating expenses to sales might indicate high functional intensity suggesting that the pricing methodology of Section 4 of this guidance would have reduced reliability in practice...]*

Non-base line contributions (9.a)

Scoping criterion 9.a applies a separate test to determine whether qualifying transactions should be within the scope of the simplified and streamlined approach, to further enhance the reliability of the pricing methodology described in Section 4.

Consequently, scoping criterion 9.a removes qualifying transactions from scope that are not already removed through the application of scoping criterion 8, in situations where the tested party makes non-baseline contributions to the controlled transaction. Non-baseline contributions should be specifically identified based on the accurate delineation of the transaction and considering the facts and circumstances of the qualifying transaction (see paragraph 6 of this guidance).



Amount B Public Consultation Document - Scope

Exclusions

Services

The simplified and streamlined approach applies to goods and does not capture the distribution and marketing of services.

Commodities

Qualifying transactions involving the trading, marketing or distribution of commodities are specifically excluded from scope. The general principle is that the exclusion is broad in nature and encompasses transactions involving the trading, marketing, or distribution of products of a commodity nature, whether or not they have a quoted price, and includes transactions where the commodity has undergone qualifying processing.

Administrative Simplification

A qualifying transaction is out of scope when the tested party performs non-distribution activities and the proportion of [annual indirect operating expenses allocated between the distribution and non-distribution businesses using allocation keys exceeds 30% of the total costs] accrued by the tested party for its total activities.



Amount B Public Consultation Document - Pricing

Pricing Matrix

Development of a global dataset of companies involved in baseline marketing and distribution activities.

The approximation of arm's length results has been presented as matrix segments according to the following factors: Operating asset to sales intensity (OAS); Operating expense to sales intensity (OES) and Industry.

Return on sales has been applied as the net profit indicator.

Figure 4.1 – Pricing Matrix (return on sales %) derived from the global dataset

Industry Grouping	Industry Grouping 1	Industry Grouping 2	Industry Grouping 3
[A] High OAS / any OES <i>>45%/any level</i>	3.50% <i>+/- 0.5%</i>	5.25% <i>+/- 0.5%</i>	5.50% <i>+/- 0.5%</i>
[B] Med/high OAS / any OES <i>30%-44.99%/any level</i>	3.25% <i>+/- 0.5%</i>	3.50% <i>+/- 0.5%</i>	4.50% <i>+/- 0.5%</i>
[C] Med low OAS/any OES <i>15%-29.99%/any level</i>	2.75% <i>+/- 0.5%</i>	3.25% <i>+/- 0.5%</i>	4.25% <i>+/- 0.5%</i>
[D] Low OAS / non-low OES <i><15%/10% or higher</i>	2.00% <i>+/- 0.5%</i>	2.25% <i>+/- 0.5%</i>	3.00% <i>+/- 0.5%</i>
[E] Low OAS/low OES <i><15% OAS/<10% OES</i>	1.50% <i>+/- 0.5%</i>	1.75% <i>+/- 0.5%</i>	2.25% <i>+/- 0.5%</i>



Amount B Public Consultation Document - Pricing

Steps to apply the Pricing Matrix

In order to determine the arm's length return for a tested party involved in in-scope transactions for the relevant period, a tax administration and taxpayer will apply the following 3-step process:

Step 1 - determine the relevant industry grouping of the tested party from the three possible groupings (i.e. industry grouping 1, 2 or 3) and identify the applicable vertical column of return on sales in the pricing matrix in figure 4.1 that correspond to that industry grouping.

Step 2 - determine the relevant factor intensity classification of the tested party from the five possible classifications (i.e. factor intensity classification A, B, C, D, and E) and identify the applicable horizontal row of return on sales in the pricing matrix in figure 4.1 that correspond to that factor intensity classification. The factor intensity classification of the tested party should be calculated based on a weighted average of the most recent three-year financial period.³⁰

Step 3 - identify and apply the arm's length range from the pricing matrix segment that corresponds to the intersection of the industry grouping and the factor intensity classification of the tested party.

Geographic Differences

In order to ensure the simplified and streamlined approach takes account of geographic differences in accordance with the arm's length principle, a modified pricing matrix has been established based on the observed differences in profitability between qualifying jurisdictions and the global dataset.



Amount B Public Consultation Document - Certainty

Tax certainty

- ▶ Any agreement reached under a mutual agreement (including APAs cases as well as mutual agreement cases) prior to the adoption of the simplified and streamlined approach should prevail in relation to the covered qualifying transactions.
- ▶ When the corresponding adjustment in paragraph 2 of Article 9 is invoked, the Commentary on Article 9 and Article 25 of the OECD Model Tax Convention, as well as the guidance in Chapter IV of the OECD Transfer Pricing Guidelines are relevant.



Final Thoughts

THANK YOU

