



# Euro Tax Flash from KPMG's EU Tax Centre



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## **OECD releases outline of architecture for the unified approach and a revised programme of work**

Digital Economy – OECD – Pillar One – Unified Approach – Nexus – Allocation of Taxing Rights – Arm's Length Principle – Formulary Apportionment – Pillar Two – Digital Services Tax – BEPS 2.0

On January 31, 2020, the OECD Secretariat presented the outline of the architecture on a Unified Approach on Pillar One, confirming that it is intended that both automated digital businesses and consumer facing businesses would be in scope. The OECD aims to release a final report on the technical details of the solution under Pillar One by the end of 2020.

Following a meeting of the OECD Inclusive Framework on January 29-30, 2020, on January 31 the OECD Centre for Tax Policy and Administration held a live webcast during which experts from the Center provided an update on the work relating to the tax challenges arising from the digitalization of the economy. In addition to the note on the Pillar One Architecture, an updated programme of work for Pillar One and a revised Progress Report on Pillar Two were also released.

## **Background**

The taxation of enterprises that use digital technology has been high on the international political agenda and is a key topic of focus in the broader context of the fight against base erosion and profit shifting and the perceived mismatch between taxation and value creation.

Following a mandate issued by the Finance Ministers of the G20 in March 2017, the OECD TFDE published an Interim Report in March 2018 entitled "Tax Challenges Arising from

Digitalisation” drawing on the work delivered in 2015 under Action 1 of the BEPS Project. The Interim Report (see [Euro Tax Flash issue 360](#)), which clarified that a consensus approach between members did not yet exist, was presented to G20 leaders on March 19-20, 2018 with the objective of finding a long-term solution for the issue of the taxation of the digital economy.

In January 2019, the OECD TFDE issued a policy note that identified four proposals to explore on a “without prejudice” basis. These proposals were grouped into two pillars. The first pillar (Pillar One) – which is the focus of the consultation paper – concentrated on the allocation of taxing rights and a review of profit allocation and nexus rules. It contained three proposals in relation to “user participation”, “marketing intangibles” and “significant economic presence”. The second pillar focused on measures to achieve minimum effective rates of tax.

In response to the consultation process, on May 28, 2019 a Programme of Work was adopted by the OECD Inclusive Framework on BEPS, an initiative of the OECD involving over 130 countries and jurisdictions. The Programme of Work emphasized the urgent need to agree the outline architecture of a unified approach to the taxation of the digital economy by January 2020. In particular, the Programme of Work noted that there is a considerable risk that uncoordinated unilateral tax measures will be introduced by jurisdictions where a global consensus is not reached, in turn leading to an adverse impact on investment and growth.

Following an extensive consultation process and a meeting of the OECD TFDE on October 1, 2019, the OECD Secretariat published a policy paper on a unified approach to the nexus and profit allocation challenges arising from digitalization (the OECD Proposal). For further details on the unified approach, including the new nexus and profit attribution rules (Amounts A, B and C), please refer to [Euro Tax Flash issue 413](#).

In December 2019, the OECD also held a public consultation on Pillar Two.

## **Outline of Pillar One Architecture**

A number of important points were highlighted during the January 31 live webcast and included in the note outlining the Architecture of a Unified Approach on Pillar One (“the Outline”), some of which are set out below.

### **Scope**

As previously announced, the unified approach covers highly digital business models but also consumer-facing businesses. It has now been confirmed that the scope is intended to include automated digital businesses. Examples of automated digital services provided include online search engines, social media platforms, online intermediation platforms, digital content streaming, online gaming, cloud computing services and online advertising services.

The Outline also provides a non-exhaustive list of businesses that are expected to fall within the definition of a consumer-facing business, i.e. businesses that sell goods and services directly to consumers (directly or indirectly), such as personal computing services, the sale of clothes, toiletries, cosmetics and luxury goods, branded foods and refreshments, licensing arrangements under franchise in the restaurant and hotel sector, and automobiles. It has been clarified that intermediate products and components of finished product sold to consumers would be out of scope, subject to possible exceptions.

The OECD also plans further work on determining the level of segmentation required when applying Amount A to groups with diverse activities, including within individual business lines. Where, within a business line, sales of a product or service are made to both consumers and business customers the sales that fall within the definition of a consumer-facing business would need to be identified. One such example is the sale of personal computers to both small business and consumers.

Possible carve-outs remain under consideration, including for extractive industries or financial services (including insurance activities). Consumer-facing business lines within the financial services sector, such as retail banking and insurance, have now also been added to the list of possible carve outs, for further consideration.

Size limitations are also still under consideration, such as the EUR 750 million group gross revenue threshold applied for the purposes of Country-by-Country reporting (CbCR), possible specific thresholds for in-scope revenues and additional thresholds for the computation of Amount A. An additional carve out may be considered for situations where the total profit to be allocated under the new taxing right does not meet a minimum level or where large business activities are primarily carried out in a single market jurisdiction, such as the home jurisdiction of the business.

### *Nexus*

The new nexus rules for consumer-facing businesses will be based on indicators of a significant and sustained engagement with a certain market, which will be based on – but not limited to, a minimum amount of sales revenue. The revenue threshold would be proportionate with the size of a market, with an absolute minimum amount to be determined. The OECD intends for the final agreement to include exact figures for the minimum amount, which are yet to be determined.

For automated digital services, nexus will be determined only based on the revenue threshold.

Businesses that conduct other in-scope activities, such as sale of tangible goods, will not be deemed to have nexus where the selling of consumer goods is not accompanied by a sustained interaction with the market.

The OECD aims for a manageable implementation and administration system for the new nexus rule. In this context, a simplified reporting and registration-based mechanisms (such as a “one stop shop”) and exclusive filing in the ultimate parent jurisdiction (similar to the approach used for CbC reporting) are being considered.

### *Profit allocation rule*

*In relation to Amount A*, the OECD noted that the outcome of the public consultation process indicated that profit before tax (“PBT”) is the preferred profit measure to calculate the “deemed residual” profit. The PBT would apply to both profits and losses and consistently year-to-year. It was also confirmed that Amount A will be based on a measure of profit derived from the consolidated group financial accounts. The possibility to weigh the quantum of Amount A to account for different degrees of digitalization (i.e. applying different percentages for different businesses) is also being considered. Further work will also be done on elimination of double taxation under Amount A, including addressing the need for a new multilateral convention,

which would include a double taxation relief mechanism where not addressed by existing treaties.

*With regard to Amount B*, it is envisaged that the fixed return for certain baseline marketing and distribution activities taking place in market jurisdictions would approximate the remuneration determined according to existing rules, i.e. the arm's length principle. The OECD plans further work on determining how to account for different functionality levels and differences between regions and industries (e.g. those experiencing systematic low systems profits).

The OECD confirmed that the option to implement Pillar One on an opt-in basis (also referred to as the global safe harbor system) will be considered. Under this alternative system, a multinational group would decide – on a global basis, whether to be subject to Pillar One.

#### *Dispute prevention and resolution*

The OECD intends to develop a new multilateral mechanism to prevent and resolve disputes. To ensure certainty and timely resolution of disputes, it is proposed that the new mechanism (e.g. arbitration) will be mandatory and binding and – in particular with respect to Amount A, provide certainty before tax assessments are made, to prevent disputes from arising. It is noted that certainty is needed over all aspects of Amount A, including scope, delineation of business lines, nexus, and which jurisdictions should provide relief from double taxation. Under the proposed approach, participating tax administrations would provide early tax certainty for Amount A, for example by setting-up representative panels to review and resolve issues of certainty.

#### **Revised Progress Report on Pillar Two**

The package published on January 31 also includes a Revised Progress Report on Pillar Two, which notes that further discussion on the so-called "GloBE proposal" are underway, with a number of key elements still under consideration. The fixed minimum (fixed) tax percentage under the income inclusion rule is yet to be determined and further work will be carried out on the question of blending tax rates, with regard to differences between tax and financial accounting, but also on possible carve-outs (e.g. for regimes that are compliant with the BEPS Action 5 standards). The programme of work also includes the development of a simple switch-over rule, while the subject to tax rule is still under discussion.

#### **Next steps**

This revised programme of work (PoW) sets out the following timeline:

- Agreement in the Inclusive Framework on the key policy features of a consensus-based solution to the Pillar One issues by **July 2020**;
- A final report on the technical details of the solution by the **end of 2020**.

The OECD notes that certain parts of the work programme will need to be completed in June 2020, including for example the definition of the categories of business activities falling within the scope of the new taxing right and the determination of the appropriate thresholds for the percentage(s) of profit that will be reallocated under the new taxing right.

## EU Tax Centre comment

The OECD has set an ambitious timeline for 2020, against a backdrop of unilateral measures to tax digital companies, such as the introduction of digital services taxes into local law. Some of these initiatives in European Union member states have been put on hold while further work is being done at the level of the OECD, but will likely kick in if consensus cannot be reached by the end of this year. A number of essential issues are still subject to debate, including the proposal to introduce a safe harbour rule for Pillar One, on which a number of jurisdictions have already raised concerns. Making the dispute prevention and resolution mechanism binding – which is a crucial element of Pillar One, is another area of divergence that will have to be addressed.

Despite earlier speculation that a detailed discussion draft for Pillar Two will be released for public comment by April 2020, no such commitment was made by the OECD in the its announcement on January 31, 2020.

Should you have any queries, please do not hesitate to contact [KPMG's EU Tax Centre](#), or, as appropriate, your local KPMG tax advisor.



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