

1 Executive summary

1.1. Introduction

1. Digital transformation spurs innovation, generates efficiencies, and improves services while boosting more inclusive and sustainable growth and enhancing well-being. At the same time, the breadth and speed of this change introduces challenges in many policy areas, including taxation. Reforming the international tax system to address the tax challenges arising from the digitalisation of the economy has therefore been a priority of the international community for several years, with commitments to deliver a consensus-based solution by the end of 2020.

2. These tax challenges were first identified as one of the main areas of focus of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, leading to the 2015 BEPS Action 1 Report (the Action 1 Report).¹ The Action 1 Report found that the whole economy was digitalising and, as a result, it would be difficult, if not impossible, to ring-fence the digital economy. In March 2018, the Inclusive Framework, working through its Task Force on the Digital Economy (TFDE), issued *Tax Challenges Arising from Digitalisation – Interim Report 2018* (the Interim Report)² which recognised the need for a global solution.

3. Since then, the 137 members of the Inclusive Framework have worked on a global solution based on a two pillar approach.³ Pillar One is focused on new nexus and profit allocation rules to ensure that, in an increasingly digital age, the allocation of taxing rights with respect to business profits is no longer exclusively circumscribed by reference to physical presence. Globalisation and digitalisation have challenged fundamental features of the international income tax system, such as the traditional notions of permanent establishment and the arm's length principle (ALP), and brought to the fore the need for higher levels of enhanced tax certainty through more extensive multilateral tax co-operation. These transformational developments have taken place against a background of increasing public attention on the taxation of highly digitalised global businesses, which has in turn reinforced the political pressure and imperative to address the issue.

4. Members of the Inclusive Framework agreed that any new rules should be based on net basis taxation, should avoid double taxation and should be as simple as possible. They stressed the importance of tax certainty and the need for improved dispute prevention and dispute resolution tools. The members are mindful of the need to ensure a level playing field among all jurisdictions: large or small, developed or developing. Also mindful of limiting compliance and administrative burdens, Inclusive Framework members agreed to make any rules as simple as the tax policy context permits, including through the exploration of simplification measures.

5. Following a proposal made by the Secretariat,⁴ the Inclusive Framework agreed upon an outline of the architecture of a “Unified Approach” in January 2020 as the basis for the negotiation of the Pillar One solution (the “Outline”).⁵ Since January, and in spite of the outbreak of COVID-19, all members have worked on the technical development of all the building blocks that make up Pillar One. This is a Report on the blueprint for Pillar One (the “Blueprint”). It describes, in detail, the main features of the building blocks of Pillar One and identifies the areas where political decision is needed. It shows that there has been significant progress towards a global agreement, and contains proposals to bridge remaining divergences. It recognises that further technical work will be required to finalise some aspects of Pillar

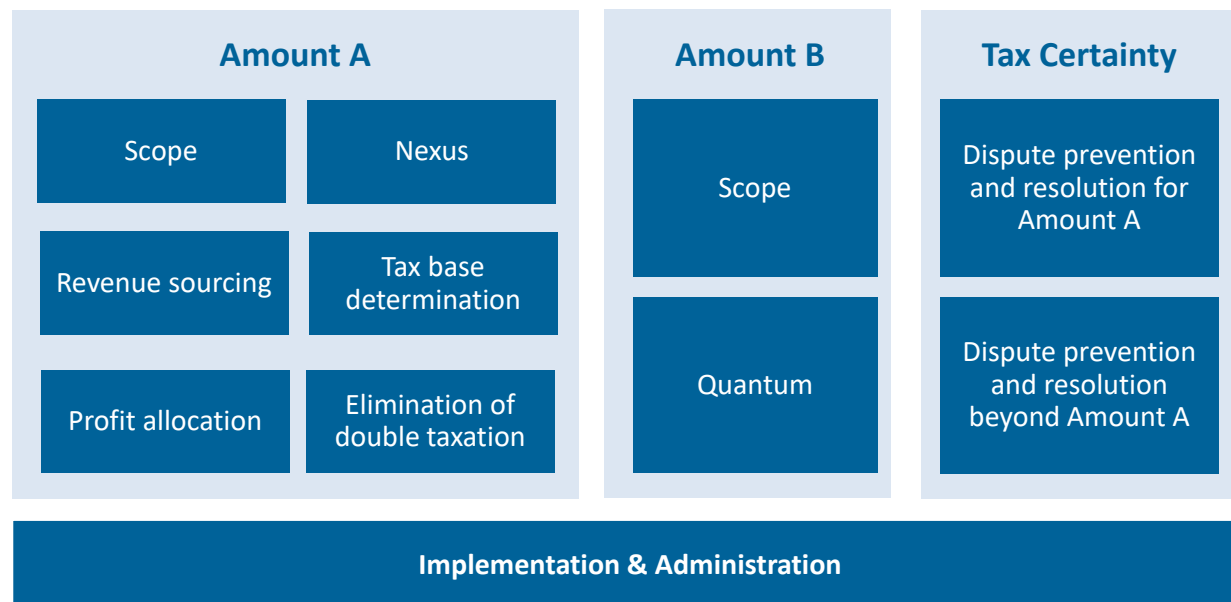
One, for example to reduce complexity, improve administrability, and meet the available capacities of both developed and developing economies.

1.2. Pillar One Blueprint

6. Pillar One seeks to adapt the international income tax system to new business models through changes to the profit allocation and nexus rules applicable to business profits. Within this context, it expands the taxing rights of market jurisdictions (which, for some business models, are the jurisdictions where the users are located)⁶ where there is an active and sustained participation of a business in the economy of that jurisdiction through activities in, or remotely directed at, that jurisdiction.⁷ It also aims to significantly improve tax certainty by introducing innovative dispute prevention and resolution mechanisms. Pillar One seeks to balance the different objectives of Inclusive Framework members and result in the removal of relevant unilateral measures.

7. Consistent with the Outline, the key elements of Pillar One can be grouped into three components: a new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment) level (Amount A); a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the ALP (Amount B); and processes to improve tax certainty through effective dispute prevention and resolution mechanisms. Eleven building blocks have been identified as essential to the construction of Pillar One, and constitute the bedrock of this Blueprint.

Figure 1.1. Building Blocks of Pillar One



8. While the technical work on the Pillar One building blocks is very advanced, Inclusive Framework members recognise that there are a number of open issues on key features of the solution that can only be resolved through political decisions. To complete the package, political decisions are required on a number of issues including the following:

- **Scope:** With the Outline agreed in January 2020, the Inclusive Framework tried to bridge the gap between those members seeking to focus Pillar One on a narrower group of “digital” business models and those insisting that a solution should cover a wider scope of activities. As a result, two categories of activities to be included in the scope of the new taxing right created by Pillar One were identified: Automated Digital Services (ADS) and Consumer Facing Businesses (CFB). As

discussed below, considerable technical work has been done on how these categories could be defined, but to date political agreement has not been reached on the use of these categories, and the scope issue is not yet solved. In order to deliver a solution in 2020 in accordance with the G20 mandate, some members have advocated for a phased implementation with ADS coming first and CFB following later. One member proposed implementing the new taxing right on a “safe harbour” basis, which would enable an MNE group to elect on a global basis to be subject to Pillar One.⁸ The scope of Amount A remains to be settled upon.

- **Amount of profit to be reallocated (the “Quantum”):** Agreement on how much residual profit would be reallocated under the new taxing right, which depends on the determination of different threshold amounts and percentages for the purpose of scope, nexus and profit allocation (the formula),⁹ is conditioned on agreement on scope. However, much work has been completed on the impact of different thresholds and percentages of profit to be allocated so that a political decision could be taken quickly as part of an overall political agreement. Also, some Inclusive Framework members are of the view that, beyond residual profit, a portion of routine profit should also be allocated to market jurisdictions in the case of remote marketing and distribution activities facilitated by digitalisation. Other members proposed “differentiation mechanisms” in order to increase the quantum of profit reallocated to market jurisdictions for certain business activities (for example, ADS), or a scalable reallocation depending on the profitability of the business (profit escalator). These variations to the Amount A profit allocation rules proposed by some Inclusive Framework members have not been decided upon.
- **Extent of tax certainty:** While all members have agreed on the need for an innovative solution to deliver early certainty and effective dispute prevention and resolution for Amount A, there continue to be differences of view on the scope of mandatory binding dispute resolution beyond Amount A. The Blueprint contains proposals to bridge these divergent views. A decision on this issue will need to be part of a comprehensive agreement also covering the other two open political issues on quantum and scope.
- **Scope and application of Amount B:** While this Blueprint contains an outline of a solution that assumes that in-scope distributors are to be identified based on a narrow scope of baseline activities, there is interest by some members to explore the feasibility of broadening the scope of Amount B. Some Inclusive Framework members have expressed the need to further refine the design of Amount B such that the intended simplification benefits are achieved, and further consider that implementation through a pilot programme at first may allow for some evaluation of the benefits in practice. The Inclusive Framework will therefore need to decide how to proceed.

9. Subject to these pending political issues, the Pillar One Blueprint is described below.

1.2.1. The new taxing right (Amount A)

10. The new taxing right (Amount A) would be an overlay to the existing nexus and profit allocation rules. It would apply broadly and would not be limited to a small number of MNEs in a particular industry. However, given its innovative features, Inclusive Framework members are mindful of the need to keep the number of MNEs affected at an administrable level and have agreed to consider thresholds and other features that help keep the approach targeted while minimising compliance costs and being mindful of capacity considerations for tax administrations. The key design features of the new taxing right would include:

- A **revenue threshold** based on annual consolidated group revenue coupled with a **de minimis foreign in-scope revenue** carve-out. These thresholds are intended to minimise compliance costs and keep the administration of the new rules manageable for tax administrations. To avoid tax administrations being overwhelmed with the initial operation of the new taxing right, one option under consideration is to implement these thresholds on a phased approach. This could start with

higher thresholds that could either be gradually reduced over a number of years or be applied for a longer period and then only start the reductions after a post-implementation review has been undertaken. A phased approach may help to make the new rules manageable for both tax administrations and businesses and will allow both to gain practical experience before expanding coverage to a wider set of MNEs. Other approaches that seek to achieve these objectives could also be explored, including the option of a threshold based on in-scope revenues. No decision has yet been taken on the number of the revenue thresholds, the amount of these thresholds or the use of a phased approach.

- **Scoping rules** covering ADS and more broadly CFB. This includes businesses that are able to have significant and sustained interactions with customers and users in a market jurisdiction.
- The use of a **new nexus rule** to identify market jurisdictions eligible to receive Amount A. The nexus rules balances the interests of smaller jurisdictions, in particular developing economies, in benefiting from the new taxing right with the need for low and proportionate compliance costs, where appropriate in light of the overall balance, while avoiding spill-over effects in other tax and non-tax areas.
- The nexus rules are supported by detailed **sourcing rules** that are reflective of the particularities of digital services and consumer-facing businesses and balance the need for accuracy with the ability of in-scope MNEs to comply and the cost of doing so. It has been proposed that this may be achieved through due diligence rules subject to a clearly defined hierarchy, likely to be of particular importance in connection with third party distribution.
- An administrable approach for **reallocating residual profit**. Eligible market jurisdictions will receive a portion of (X%) of residual profit (income exceeding an agreed level of profitability of (Y%)) using a formula. To strike a balance between simplicity and accuracy, the calculation of the relevant measure of profit will rely as much as possible on published consolidated financial accounts. Book-to-tax adjustments (similar to those required for Pillar Two) and segmentation will be limited to a minimum. In practice, most MNEs will compute their Amount A profit (the tax base) on the basis of their consolidated accounts (including groups with out-of-scope activities), but only the portion of that group profit determined by a formula corresponding to in-scope revenue will end up being allocated to market jurisdictions. Accuracy and ensuring a level playing field between different MNEs (e.g. in-scope business line with a significantly different profitability from other business lines) may require the determination of the relevant measure of profit on a segment basis, but only in limited cases where the MNE will likely already prepare segmented accounts for financial reporting purposes. Further simplifications will be available for MNEs that compute a segmented tax base, such as the allocation of indirect costs through a revenue-based allocation key. In total, it is expected that only a small number of groups would be required to segment their tax base under Amount A.
- **A loss carry-forward regime** to ensure that there is no Amount A allocation where the relevant business is not profitable over time. To ensure Amount A applies only to economic profit, consideration will be given to MNEs in scope being allowed to bring existing losses incurred prior to the introduction of Amount A into this loss carry-forward regime. The regime will rely on an earn-out mechanism to enable offsetting past losses against future profit. Amount A losses will be preserved and carried forward in a single account at the level of the group (or segment level where relevant), and not allocated to individual market jurisdictions.
- In addition to the proposed mechanism to eliminate double taxation, different options are being considered to adjust the allocation of Amount A to market jurisdictions where an MNE already leaves residual profits under the existing ALP-based profit allocation rules (so-called “double counting” issues), including **a marketing and distribution profits safe harbour**. This approach would conceptually consider the income taxes payable in the market jurisdiction under existing taxing rights and Amount A together, and adjust the quantum of Amount A taxable in a market

jurisdiction, limiting it where the residual profit of the MNE is already allocated to that jurisdiction as a result of the existing profit allocation rules. Under the safe harbour, groups that already allocate profits to market jurisdiction in excess of the safe harbour return would in some instances not pay Amount A or apply the mechanism to eliminate double taxation and thus could continue to allocate profits under the current rules. Other approaches considered to deal with double counting issues, next to the mechanism to eliminate double taxation, include the domestic business exemption.

- The **mechanism to eliminate double taxation** will have two components: (i) identification of the paying entities; and (ii) the methods to eliminate double taxation. To identify the entity or entities that will bear the Amount A tax liability, the “paying entities”, a process with up to four steps is contemplated. First, a qualitative activities test to identify entities that earn residual profit using a positive and negative list of indicia (which will be applied based on existing transfer pricing documentation). A profitability test would then be applied to ensure these entities have the ability to pay Amount A. As a priority rule, the Amount A tax liability for a market jurisdiction would first be allocated to paying entities that are connected to a market jurisdiction. But, where the paying entities connected to a market do not have sufficient profits to bear the full liability, any outstanding liability could be apportioned between other paying entities (not connected to a market) on a pro-rata basis, or on other alternative “back-stop” bases that are being considered. Consideration will also be given as to whether and how this process could be simplified by eliminating the first (activities) and/or third (market connection priority) test and applying a more strictly quantitative and formulaic approach. Having identified the entity or entities that would bear an Amount A tax liability, a residence jurisdiction would then use the exemption or credit method to relieve double taxation.
- Where an MNE is subject to the new taxing right, a **simplified administrative process** will be developed to minimise the complexity, burden and cost of filing and payment, which is aimed at benefitting tax administrations and taxpayers alike.
- The **new Amount A taxing right would be implemented** through changes to domestic law, and by way of public international law instruments, in particular, a multilateral convention would be required. The domestic law and multilateral convention would be supplemented by guidance and other instruments where necessary.

1.2.2. The fixed return for defined baseline marketing and distribution activities (Amount B)

11. The purpose of Amount B is two-fold. First, it is intended to simplify the administration of transfer pricing rules for tax administrations and lower compliance costs for taxpayers. Second, Amount B is intended to enhance tax certainty and reduce controversy between tax administrations and taxpayers. For this reason, it has been acknowledged by a number of Inclusive Framework members and MNEs as a key deliverable of Pillar One on the presumption that the intended benefits may be achieved.

12. Amount B will standardise the remuneration of related party distributors that perform “baseline marketing and distribution activities” in the market jurisdiction. The definition of baseline marketing and distribution activities covers distributors that (i) buy from related parties and resell to unrelated parties; and (ii) have a routine distributor functionality profile.

13. Further, the activities in scope are first defined by a ‘positive list’ of typical functions performed, assets owned and risks assumed at arm’s length by routine distributors (based on a narrow scope, akin to limited risk distributors). A ‘negative list’ of typical functions that should not be performed, assets not owned and risks not assumed at arm’s length by routine distributors are also used to qualitatively measure the additional factors that would deem a distributor as being outside the scope of Amount B. Certain quantitative indicators are then used to further support the identification of in-scope activities.

14. Amount B is intended to approximate results determined in accordance with the ALP, and therefore would be based on comparable company benchmarking analyses under the Transactional Net Margin Method (TNMM) with the quantum potentially varying by industry, as well as region, provided any such variation is supported by the relevant benchmarking analysis.¹⁰ As a result Amount B could have a number of ranges of potentially appropriate fixed returns. Each fixed return provided to remunerate baseline marketing and distribution activities under Amount B is intended to deliver a result that approximates results determined in accordance with the ALP.

15. While some members view that Amount B may provide certain benefits, in terms of tax certainty and as a simplification of the ALP, there remain divergent views on the breadth of baseline activities that should be included in its scope. This Blueprint assumes that in-scope distributors are to be identified based on a narrow scope of baseline activities, which is a view shared by a group of Inclusive Framework members. However, there is another group of members, particularly developing countries, that consider the rule will be only be effective in its policy objective if it is broad in scope and wish to explore broadening the scope of Amount B. There is also some interest in exploring the implementation of Amount B through an initial pilot programme, in order to measure how simplification benefits may be achieved. The precise definitions of regions, industries and the relevant activities and indicators is to be finalised through further technical work.

1.2.3. Improved tax certainty processes

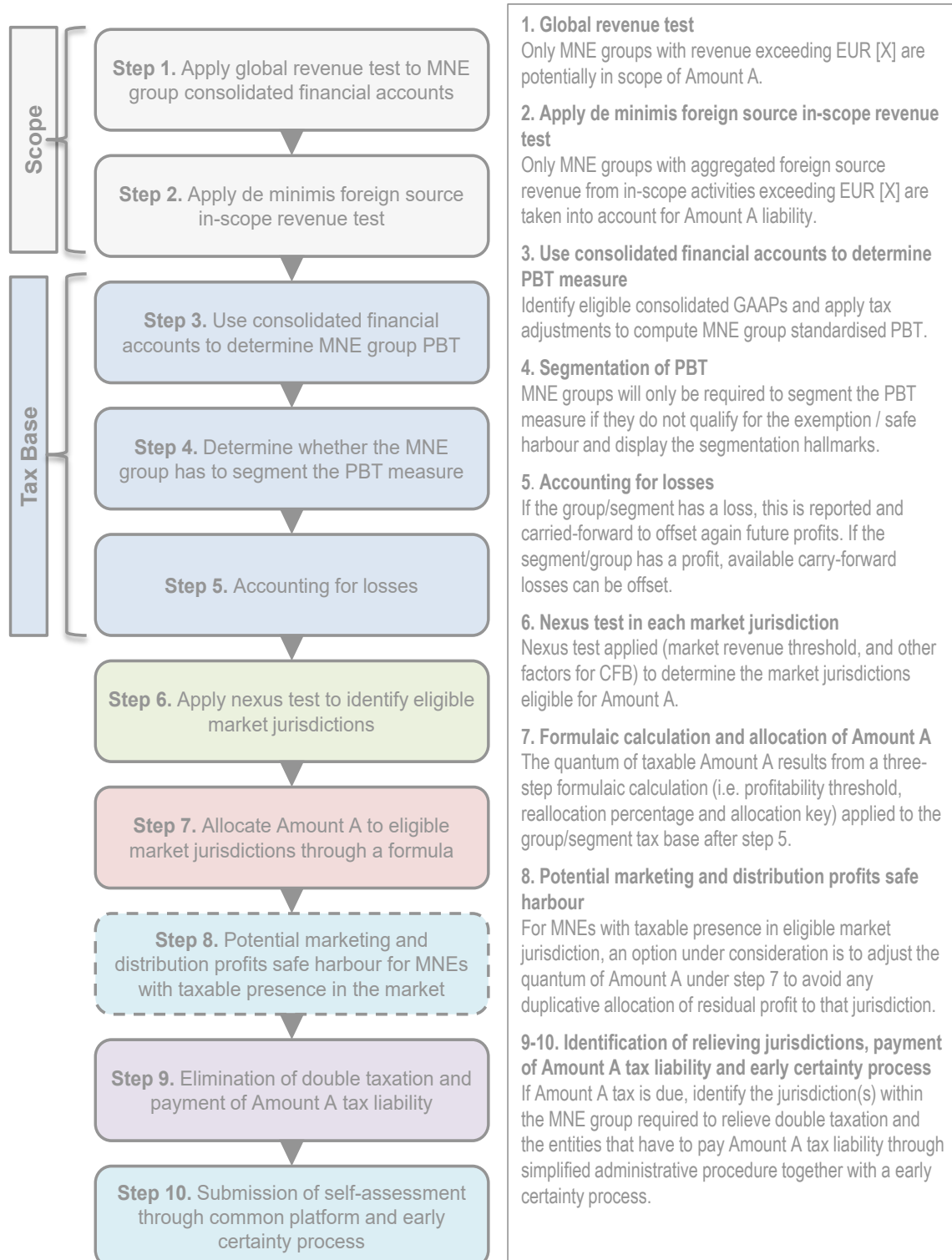
16. Tax certainty is a key component of Pillar One and is core to this Blueprint which provides for innovative dispute prevention and dispute resolution mechanisms.

Dispute prevention

17. The new taxing right will be determined by the application of a formula to a newly defined tax base, corresponding to a portion of the residual profit of large MNEs' in-scope activities. The Blueprint embeds a mechanism to ensure that the application of the new taxing right to a particular MNE group is agreed among all interested jurisdictions. A panel mechanism would be put in place for tax administrations, working with the relevant MNEs, to agree on: (i) the tax base, in particular where there is business line segmentation; (ii) the result of the implementation of the formula, and (iii) any other feature of the new taxing right, including the paying entities and elimination of double taxation. It is also recognised that the resource implications of the multilateral process are significantly less than the resources that would be required by unilateral uncoordinated compliance activities.

18. As described in section 1.2.2, Amount B is intended to enhance tax certainty and reduce controversy between tax administration and taxpayers, particularly in jurisdictions where there are constraints in dealing with transfer pricing disputes. It does so by standardising the remuneration of related party distributors that perform 'baseline marketing and distribution activities'.

Figure 1.2. Overview of the process map for Amount A



Dispute resolution

19. In addition to the innovative dispute prevention mechanisms, the Blueprint includes innovative dispute resolution mechanisms. Members of the Inclusive Framework agreed that, in the event a dispute related to Amount A might arise that is not dealt with by the Amount A dispute prevention process, appropriate mandatory binding dispute resolution mechanisms will be developed.¹¹ Members of the Inclusive Framework also agreed to explore mandatory binding timely dispute resolution mechanisms for disputes not related to the application of the new taxing right. These mechanisms should be respectful of jurisdictions' sovereignty, with consideration paid to the case of certain developing economies with no or low levels of mutual agreement procedure (MAP) cases. As indicated above, agreement on the scope of mandatory binding dispute resolution beyond Amount A is still pending.

1.2.4. Process map

20. To illustrate how the Blueprint would apply in practice, the below contains an overview of the process map to apply its various elements (focusing on Amount A). More details on the different steps described in this process map are available in Annex A.

Notes

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 *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.

⁴ Public Consultation Document, *Secretariat Proposal for a “Unified Approach” under Pillar One*, 9 October 2019 – 12 November 2019.

⁵ OECD (2020), *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 – January 2020*, OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

⁶ 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.

⁷ Conversely, to ensure elimination of double taxation, this new taxing right will reduce the taxing rights of jurisdictions where MNE entities entitled to residual profits under the existing profit allocation rules are resident.

⁸ On 3 December 2019, the US Treasury Secretary, Steven Mnuchin sent OECD Secretary General Ángel Gurría a letter, which, while reiterating the US support for a multilateral solution, proposed that Pillar One be implemented on a ‘safe harbour’ basis.

⁹ It should be noted that other features of Pillar One will have an impact on quantum, such as the question of whether the Amount A loss carry-forward regime is extended to “profit shortfalls”, the treatment of pre-regime losses, the issue of double counting (and possible inclusion of a marketing and distribution safe

harbour), the process for identifying the “paying entities” (to eliminate double taxation). All these features will be relevant in the discussion of the quantum of Amount A.

¹⁰ Relevant industry categories could include: fast moving consumer goods (FMCG), motor vehicles, ICT, pharmaceuticals and general distribution.

¹¹ This will require reaching consensus on such dispute resolution mechanism.



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