

Organisation for Economic Co-operation and Development
Tax Treaties, Transfer Pricing and Financial Transactions Division OECD/CTPA

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**Subject: Comments on OECD Public Consultation Document:
Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing**

BDO is one of the largest full-service audit, tax and advisory organisations in the world. We have over 97,000 people in over 1,700 offices in 167 countries and territories. Our global organisation focuses on supporting entrepreneurially spirited, ambitious businesses.

We appreciate the opportunity to submit our comments on the public consultation document titled “**Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing**” (Draft Model Rules) that was released by the OECD on 4 February 2022 and to provide our input on the OECD’s ongoing work in respect of this important tax policy matter.

Our comments address four key points:

- **Accuracy v. Practicality** - The Pillar One revenue sourcing rules must strike the right balance between accuracy and practicality. They must be administrable by MNE taxpayers, and the results must be verifiable by the tax authorities. More detailed revenue sourcing rules may result in more accurate allocations, but that enhanced accuracy may come at the price of reduced workability. We provide comments on striking the balance between accuracy and practicality.
- **An Alternative Approach** - We suggest a reordering of the Draft Model Rules’ approach to revenue sourcing, one that we believe better balances the goals of accuracy and practicality.
- **Pressure on the Binding Dispute Resolution Mechanism** - The Draft Model Rules seem to implicitly place considerable pressure on the workings of the to-be-determined binding dispute resolution mechanism under Pillar One. If certain aspects of the Draft Model Rules were revised, we believe that fewer cross-border disputes would arise, thereby easing the pressure on the binding dispute resolution mechanism.
- **Future Commentary** - Many critical aspects of the Pillar One Amount A rules are left to a future commentary. We believe this bifurcation of the guidance on the sourcing of revenue for purposes of Amount A may present problems in implementation.

Overall, delivering simplicity in administration and seeking to ease, rather than increase, the compliance burden and uncertainty for taxpayers is of paramount importance in an increasingly complex global environment. These overarching principles should be reflected in the design of all aspects of the new rules.



Our comments, developed by a BDO global working party, are set out in detail below. We hope they will be of assistance to the OECD and the Task Force on the Digital Economy (TFDE). If you have any questions or would like any further detail, please do not hesitate to contact us. We look forward to working with you and supporting you as you continue your work in this area.

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**COMMENTS ON OECD PUBLIC CONSULTATION DOCUMENT
PILLAR ONE – AMOUNT A: DRAFT MODEL RULES FOR NEXUS AND REVENUE SOURCING**

The Draft Model Rules relating to nexus and revenue sourcing provide the first building blocks under Pillar One. Of the two sets of rules, the revenue sourcing rules pose the more complex questions, and our comments will therefore focus on those.

As the statement accompanying the release of the Draft Model Rules notes, “The revenue sourcing rules have been designed to fulfil the policy objective of accurately identifying the market jurisdiction and the associated revenue, while limiting and simplifying compliance burdens as much as possible.” However, the statement acknowledges that striking the right balance between accuracy and operational realities is a challenge, and notes that the TFDE is particularly interested in stakeholder input on how to better strike that balance. It is in that spirit that we offer our comments on the Draft Model Rules.

The Trade-off Between Accuracy and Practicality

The Background to the Draft Model Rules provides as follows:

The revenue sourcing rules have been designed to balance the need for accuracy with the need to limit compliance costs. The revenue sourcing rules provide a methodology for a Covered Group **to use available information** to reliably identify the market jurisdiction based on a range of possible indicators ... [Emphasis added]

Moreover, it explains that

The revenue sourcing rules will be supported by **detailed record-keeping requirements, based on a systemic-level review of the approach taken to revenue sourcing, rather than a requirement to retain and supply information from every transaction to tax administrations.** This means showing a clear, intelligent internal control framework demonstrating a Covered Group’s conceptual approach to revenue sourcing, how it obtains the necessary data and that it has sound internal checks to monitor the accuracy of that data. [Emphasis added]

While the TFDE’s clear endorsement of these guiding principles as the basic underpinnings of the Draft Model Rules is welcome, the proposed rules do not always appear to have achieved this goal.

For example, Paragraph 2 of the Source Rules in the General Articles provides that “[R]evenues must be sourced on a transaction-by-transaction basis.” Footnote 3 adds that the as-yet unreleased commentary that will accompany the Draft Model Rules “will explain the transaction-by-transaction approach,” but generally, covered MNEs will have to determine the source of each transaction that generates income - “the individual item of inventory, or the ‘clicks’ on an online advertisement.” For large, global companies subject to Pillar One, this would mean (with some carve-outs) tracing transactions through their global supply chains to identify the ultimate consumer for each one.

Footnote 3 further explains the transaction-by-transaction approach in relation to the question as to how an MNE would document its revenue sourcing practices:

While the allocation of the revenue is at an itemised level, **which necessitates access to the initial transaction record to answer the sourcing rule**, the Covered Group is **not required to retain that data** on every item. Instead, as noted in the introduction, the approach to compliance would be at a systems level, and not at an individual transaction level. [Emphasis added]

Thus, in complying with the revenue sourcing rules, an MNE would need to *obtain* access to transaction records for each transaction that generates income but would not necessarily need to *retain* that data. While some of this information may be readily available, businesses may nonetheless need to adapt their internal systems to track every transaction for purposes of sourcing. In light of these considerations, it would be difficult to conclude that this requirement would not impose onerous compliance costs on covered MNEs.

While the Draft Model Rules therefore limit the *documentation* that an MNE must retain and have available, virtually *every* transaction and *every* item of revenue must still be sourced. In practice, therefore, the higher-level, systemic record-keeping requirement does little to relieve the burden of the granularity required for transaction-by-transaction revenue sourcing.

To gain some perspective, it might be helpful to look back at the evolution of Pillar One and Amount A. The framework that was shared with the public on October 9, 2019, “Secretariat Proposal for a ‘Unified Approach’ under Pillar One,” was developed with the recognition that a partially formulary approach to address the allocation of taxing rights to market jurisdictions provided an appropriate trade-off between accuracy and workability. The trade-off was revisited with the October 14, 2020 release, “Tax Challenges from Digitalization – Report on Pillar One Blueprint.” In this document, a model was proposed that required MNEs to perform sometimes complex allocations of revenue to in-scope and out-of-scope activities. After receiving extensive comments, the scoping model was greatly simplified, and the current revenue and profitability thresholds were adopted. A similar rebalancing might be in order regarding the revenue sourcing rules of the Draft Model Rules to ensure that the balance does not skew toward ensuring accuracy at the expense of workability.

An Alternative Approach

The Draft Model Rules set out different revenue sourcing rules for approximately 20 different categories of transactions, covering goods, services and intangible property, among others. For each category of transaction, the sourcing rule specifies a “Reliable Method,” which is a combination of one or more specified Reliable Indicators, an unspecified “Another Reliable Indicator” and in six categories of transactions, an Allocation Key. The Allocation Key can be used when specifically permitted and when the MNE has demonstrated that it has taken reasonable steps to identify a Reliable Indicator but cannot do so.

Concerns arise regarding the extent to which an MNE must attempt to identify a Reliable Indicator, and how it must document this effort. Most of the guidance in the Draft Model Rules describes Reliable Indicators, which are derived from information not always available to tax departments, and perhaps not available to the MNE at all. For example, one method for sourcing revenues from the sale of finished goods to final customers through an independent distributor relies on information regarding the location of the final customer. Similarly, revenues from the sale of components that are incorporated into finished goods may be sourced by determining the location of the final customer of the finished good. It is

unlikely that information regarding the location of final customers in either type of sale will be generally available to the MNE. In both of these cases, the use of an Allocation Key is allowed, but only if the MNE demonstrates and documents that it has taken reasonable steps to identify a Reliable Indicator and has concluded that no Reliable Indicator is available.

Paragraph 2(7) of Schedule A of the Draft Model Rules sets out exceptions to the general rule and appears to allow MNEs to use either an Allocation Key or the Global Allocation Key, regardless of the applicable revenue sourcing rule. This provision may provide a way for MNEs to use an allocation key instead of trying to obtain the required information for the application of a specific sourcing rule.

Building on the concept embodied in Paragraph 2(7) that allows for the use of an Allocation Key, we recommend that the final revenue sourcing rules adopt an approach whereby an allocation key is the **primary** mechanism for revenue sourcing. A reasonable allocation key should be sufficient and preferable to what may turn out to be a difficult and unsuccessful search for transaction-by-transaction data for many MNEs, especially those outside of the digital economy.

As a secondary approach, we propose that the revenue sourcing rules specified for the different transaction types in the Draft Model Rules could be applied if an MNE wanted to do so and could demonstrate that the approach would yield a Reliable Indicator. But we believe that the primary methodology should be the use of an allocation key. Under this approach, an MNE would not have to search for data within or outside its group in order to allocate revenue, nor would it have to demonstrate that it tried but failed to identify a Reliable Indicator. We believe this approach would greatly simplify the implementation of Pillar One.

On a more general note, rather than trying to identify all possible types of intercompany transactions and to develop specific revenue allocation guidance for each, a revised version of the revenue sourcing rules might do better to follow the general approach of the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Guidelines). The OECD Guidelines focus on transaction types rather than specific transactions and provide guidance for the general categories of tangible goods, services, intangibles and financial transactions. The Draft Model Rules could be greatly simplified by focusing on these general categories of intercompany transactions and allowing allocation keys to be used as a primary mechanism for allocating revenue.

The Binding Dispute Resolution Mechanism

Disparities in the implementation of revenue sourcing guidance by tax jurisdictions around the world may lead to an increase in disputes over taxing rights between jurisdictions. Jurisdictional implementation differences may result in a greater risk of inconsistent approaches and double taxation, which in turn may increase pressure on the binding dispute resolution mechanism.

The Draft Model Rules make no mention of a binding dispute resolution mechanism to resolve such disputes. We understand that the details of this mechanism will be released separately, but the revenue sourcing approach of the Draft Model Rules may put undue pressure on any dispute resolution process. We are concerned that the result will be less certainty, for longer periods of time, than would be the case if the revenue allocation rules were simplified.

Commentary to the Draft Model Rules

The introductory statement to the Draft Model Rules states that the rules will be “supported by a commentary” and that the TFDE has been charged with preparing this related commentary, which is then mentioned almost 50 times in the Draft Model Rules.

The plan to provide additional guidance in connection to the Draft Model Rules is commendable, and we look forward to being able to provide input on it. However, the Draft Model Rules in their current form relegate too many key areas to the future commentary, rendering it difficult to provide insightful feedback when many elements of the guidance are not yet fully developed.

Perhaps the best example of this dynamic relates to the concept of “reasonable steps.” Footnote 9 provides that the commentary will provide further guidance on the rules on reliable methods, specifically, guidance on what would be regarded as reasonable steps to identify a Reliable Indicator. Paragraph 2(6)(b) provides that an allocation key may be used only “if the Covered Group demonstrates that it has taken reasonable steps to identify a Reliable Indicator and has concluded that no Reliable Indicator is available.” As a result, the concept of “reasonable steps” is central to the revenue sourcing rules. The definition of this highly subjective term thus becomes vital, but the Draft Model Rules do not provide guidance on it.

The extent and importance of the topics to be addressed by the commentary is concerning. It will therefore be important for stakeholders to be able to provide meaningful input as the commentary is developed.