6th Annual WBG/IMF **TAX**SUNDAY

Strengthening Tax Systems in a Digitalizing World:

Initial Reactions to Pillar 1 “Unified Approach”

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OECD Secretariat DD Pillar 1 “Unified Approach” – Initial Reactions in 5 Minutes

Pillar 1 unified approach:

- Scope
- Nexus
- Profit Allocation

OECD Secretariat DD Pillar 1 “Unified Approach” – Initial Reactions

- Scope
  - Consumer-facing businesses, not extractives, further work on scope and carve-outs. [That was clear ??]
  - But, see Rio Tinto web page:
    - “Innovation is at the heart of everything Rio Tinto does.” “That’s why we are pioneering the use of automation in mining, operating driverless trucks and establishing the world’s first fully autonomous, heavy-haul, long-distance railway system.”
    - Four technologies … to mine copper ore deep underground: 1. Powerful sensors, 2. Sophisticated data analytics, 3. Battery-powered and autonomous vehicles, 4. Giant climate-control systems
  - Now where will that IP be held?
- Recommendation: Stay flexible on scope until you know where you are going.

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Scope – Be Careful With Carve-outs

Does this extractive business look digital to you?

"Rio Tinto unveils latest Mine of the Future™ innovation - The Processing Excellence Centre (PEC) in Brisbane, Australia, March 2014"
https://www.riotinto.com/media/photo-library-263.aspx?tx=15#

OECD Secretariat DD Pillar 1 “Unified Approach” – Initial Reactions

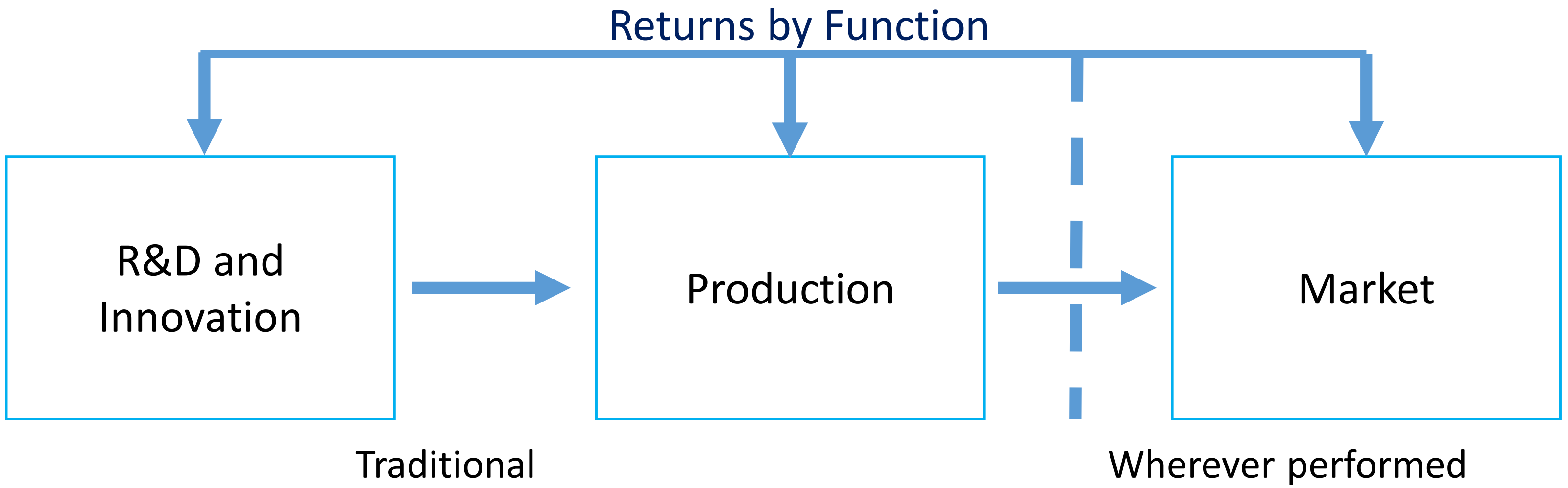
- Nexus
  - For businesses within scope – [??], nexus not dependent on physical presence, but
    - “Largely” based on sales
    - Could have country specific sales thresholds so smaller companies can also benefit.
- Recommendation:
  - Let each country decide threshold for non-physical presence (who can disagree with the need?)
  - May need non-physical presence for production/extraction situations too. (See prior slide)
  - Treaty should permit non-physical presence PE, but can have agreed limit (similar to building or construction site)

OECD Secretariat DD Pillar 1 “Unified Approach” – Initial Reactions

- New Profit Allocation Rule
  - This is the whole ball game, but it is pretty incoherent.
- Three tiers (except there are two tiers)
  1. Deemed routine profit
     - Activities in market jurisdictions – possible fixed remunerations reflecting assumed baseline activity [that was clear [??]]
  2. Deemed residual profit
     - A portion of deemed residual profit allocated to market jurisdiction
- *Amount C* – Translation: Market countries can claim more and taxpayers may complain about any of this – robust dispute resolution procedures required.
  - This is not an “amount,” but that is a quibble.

OECD Secretariat DD Pillar 1 “Unified Approach” – Initial Reactions

- Routine returns should be grounded in ALS; simplifying approaches are possible and desirable
    - Routine returns are those that cover costs and risks; how else can they be defined?
- Routine returns to investment in developing and maintaining the market – wherever that activity occurs - should go to the market country. Same for extraction? Wherever there are location specific rents?



- Residual returns should be allocated pro rata to the routine returns – unless either party carries burden to prove different attribution. Very hard to determine the source of rents and from where they derive value.

OECD Secretariat DD Pillar 1 “Unified Approach” – Initial Reactions

Round 1

- Do not conflate increased source country right to tax income with transfer pricing.
  - If we want to increase source country right to tax, i.e. based on economic activity and not physical presence, first identify the additional activity being taxed.
  - Then work on how much income that activity earns.
- There is substantial heterogeneity at the industry and firm level
  - You cannot wish it away and if not recognized there will be substantial winners and losers
  - The arm’s length standard (ALS) properly applied is not the problem. ALS strength is to recognize heterogeneity

OECD Secretariat DD Pillar 1 "Unified Approach" – Initial Reactions

Round 1, cont'd

- Transfer pricing 101: Taxpayer has the information.
- Transfer pricing 101: Tax authority has presumption of correctness. *Burden of proof in transfer pricing should always be on taxpayer to prove tax return position is correct*.
  - Information not available should be held against the taxpayer – its absence means tax authority view of facts is accepted.
  - Penalties are important deterrents.
- Process is substance.