# ICC comments in response to OECD public consultation document on the *Draft Rules for Nexus and Revenue Sourcing* under Pillar One Amount A

The International Chamber of Commerce (ICC), as the world business organization speaking with authority on behalf of enterprises from all sectors in every part of the world, appreciates the opportunity to provide input on the OECD public consultation document on the Draft Rules for Nexus and Revenue Sourcing under Pillar One Amount A. ICC advocates for a consistent global tax system, founded on the premise that stability, certainty and consistency in global tax principles are essential for business and will foster cross-border trade and investment. ICC is also an established arbitral institution through its International Court of Arbitration and provides other dispute resolution mechanisms through its International Centre for Alternative Dispute Resolution.

## General comments

ICC appreciates the efforts made to ensure that the revenue sourcing rules have been designed with the aim of accurately identifying the market jurisdiction and the associated revenue, while limiting and simplifying compliance burdens as much as possible. In this regard, ICC welcomes the opportunity to provide input on how the balance between accuracy and operational realities could be better achieved.

To this end, ICC provides the following general comments:

- ICC members believe that the requirement for MNEs to identify the location of the end user, or determine the place of delivery of the finished good, is impractical. This is particularly true for businesses that sell products to intermediaries and do not have insight or access to information related to the onward sale and destination/location of the goods to the final consumer. It is also important to recognize the challenges presented in attempting to track the jurisdiction of the final consumer, including possible breaches of competition law.

  This would suggest that an [optional] methodology using a suitable allocation key would be appropriate, and that further work on refining this would be needed. ICC members would welcome the opportunity to comment on a possible [optional] formulaic approach being explored by the Inclusive Framework to address this issue. The reason for keeping such a methodology optional is that some industries or services may not have the possibility to determine where the end user is. If such an allocation methodology was not optional, businesses would have the burden of filing tax returns in many countries where they have no physical presence and no correlation to their actual business.

- ICC members are of the view that practical difficulties could be foreseen in examining revenues on a transaction-by-transaction basis and introducing an internal control framework to demonstrate that the method is reliable. In this respect, MNEs would likely need to establish new systems to track revenues, which would be onerous in terms of administrative complexity as well as additional costs incurred. In view of the necessary time and resource investment to develop the relevant systems to comply with Amount A sourcing rules, there is

a strong likelihood that many MNEs will not be in a position to implement the rules within the timeframe envisaged.

ICC suggests that in order to counter these challenges, the Model Rules should point out that nexus should be established taking into consideration pricing variation between markets, which underpins the stated objective for the transaction-by-transaction rule. The ways to achieve this should be left to the MNEs based on the specificities of their activities.

- Whilst the rules indicate that there is no need to retain documents for the transactions themselves, they do impose "detailed record-keeping requirements", as well as a "clear, intelligent internal control framework". ICC members believe that this does not provide simplicity, particularly given that for the allocation of revenues, itemisation/transaction-by-transaction analysis is nevertheless required. This would impose additional administrative complexity and burden in terms of systems adaptation, coordination in terms of value chain management and the relevant application of the rules.

- Allocating global profits based on market-related revenues results not only in disregarding the product mix differences between markets/regions, but also in the product lifecycle for goods in different markets. The proposed revenue sourcing rules bring significant distortions regarding the appropriate distribution of Amount A, due to the departure from existing business processes and the creation of new reporting obligations.

  The proposed OECD model rules offer allocation keys where no direct allocation to market jurisdiction is possible. Where not all categories are relevant for MNEs, a group may still need to apply several sets of rules to cover all transactions in order to determine a reliable indicator. ICC believes that a more practicable approach would be preferable to avoid unnecessary administrative burden and to establish a fair balance between accuracy and operational realities. It would be useful to consider, for example, taking into account the nature of distribution agreements and allowing certain de minimis transactions to be sourced in the same way as the main transactions in order to limit the application of different rules.

- ICC members also hold that due to concerns regarding the sensitivity of the revenue sourcing data and potential competition risks, the return [which depicts the revenue allocated to each market jurisdiction], should not be exchanged with any jurisdiction.

- It would also be useful to consider the related complexity for particular industries in determining the source for revenues with respect to intellectual property or research and development payments/milestones in product development. Clarification on how to determine the source of such payments would be needed.

- ICC also respectfully notes that the proposed rules in their current form do not appear to provide sufficient simplification and clarity and will likely lead to an increase in tax disputes. There is still much ambiguity and the risk of double taxation is high. In this respect, ICC reiterates the importance of a robust early certainty process in advance of the year in question, along with dispute avoidance and dispute resolution mechanisms for jurisdictions that adopt the OECD guidance. It is critical that a co-ordinated, centralised dispute resolution mechanism be put in place for all aspects of Pillar One and Two.

- Further information is required on the methodology to be applied to determine which countries will have to surrender revenue for purposes of the proposed revenue sourcing rules as well as which countries will have to surrender their residual profits to the market jurisdictions under the Amount A reallocation. This information is required in order for businesses to determine whether an equitable result that is aligned with Pillar One policy objectives can be achieved. It is critical that such rules are scalable given the envisioned expansion of businesses that will be in scope of Amount A in the future.

  Further, this methodology should make clear that profits that are not re-allocated to the market jurisdiction will continue to be taxed in the jurisdictions in which they arise, based on the location of Functions, Assets and Risks.

- Further clarity is required as to how Pillar One will interact with Pillar Two (i.e., order of application of rules, elimination of double taxation, etc.).

- The scope of Pillar One has changed significantly since the inception of the work, to include all types of businesses. ICC members believe that further work is required to address all possible types of transactions for the allocation of Amount A and to ensure that all types of in-scope businesses are considered. As a result of the broader scope, it is necessary to consider all possible activities when developing the rules, in order for the rules to be practicable and durable for businesses and tax authorities.

## Specific comments:

1. Background [page 3] – states that "Further changes may also be needed once the scope exclusions for Regulated Financial Services and Extractives have been agreed, to ensure that there is an appropriate revenue sourcing rule for all relevant types of income."

   ICC notes that extractives companies should be given sufficient time to provide comments on the updated wording before it is finalised. To this end, it would be beneficial to have a more focused consultation with the top MNE groups that will be impacted.

2. General Articles – Nexus Test [page 5] – the draft guidelines state that "The nexus test is satisfied for a Period if the Revenues[1] of a Covered Group arising in [a Jurisdiction] pursuant to [reference to the Article on Source rules] for the Period are equal to or greater than [EUR 1 million / EUR 250 thousand].[2]"

[1] Throughout the Model Rules, Revenues is a defined term and refers to revenue derived from third parties. Revenues means the Total Revenues of a Group after the exclusion of Revenues derived from exclusions of Extractive and Regulated Financial Services. "Total Revenues" means the Revenues reported in the Consolidated Financial Statements of a Group prepared in accordance with an Acceptable Financial Accounting Standard, after applying the agreed adjustments to the tax base, as relevant.

[2] The nexus threshold will be EUR 1 million for jurisdictions with annual GDP equal to or greater than EUR 40 billion and EUR 250 thousand for jurisdictions with annual GDP of less than EUR 40 billion. The revenue threshold is currently denominated in a single currency in line with the October Statement. This raises a number of coordination issues related to currency fluctuations which will need to be discussed for the development of the MLC. The suggestion is therefore to use bracketed language in the Model Rules until an approach is agreed under the MLC, noting that for domestic legislation a re-basing mechanism is likely to be required for jurisdictions that would denominate the threshold in another currency

ICC notes that the guidelines should make clear that the threshold test will be applied to an MNE group after the Extractive and Regulated Financial Services carve out to determine whether or not the Group's remaining activities (on a consolidated basis) are in scope for Pillar One.

3. Footnote 3 [page 6] notes that "the Covered Group is not required to retain that data on every item", and that "the approach to compliance is at a system level, and not at an individual transaction level". However, without the "data on every item", it is unclear how to assess the reliability of business compliance approaches.

4. General Articles d) i) [page 7] – "Revenues derived from a transaction for the provision of Cargo Transport Services arise in [a Jurisdiction] when the Place of Origin or the Place of Destination of the Cargo Transport Service is in [a Jurisdiction]"

   ICC members note that it is unclear as to how the taxing right will be split between the Jurisdiction of Origin and the Jurisdiction of Destination.

5. General Articles h) i) [page 7] "Revenues derived from a transaction for the provision of Business to Business services to which subparagraphs (a) to (e) do not apply arise in [a Jurisdiction] when the place of use of the services is in [a Jurisdiction]."

   ICC members would welcome clarity on the interactions of Pillar One with any existing provisions that levy WHT on the same income.

6. Para 9 [page 8] clarifies that "Revenues derived from a transaction for the licensing, sale or other alienation of Intangible Property (a.) arise in [a Jurisdiction] when
   i. [..] or
   ii. the place of use of the Intangible Property by Final Customers in all other cases is in [a Jurisdiction].

   The wording included in subparagraph (ii), in particular the reference to "all other cases", seems somewhat unclear. Very similar, but clearer language is included in Part 6, para A(1)(b) (page 26).

   ICC recommends bringing the language of para 9, subparagraph (II) (page 8) in line with Part 6, para A(1)(b) (page 26):

   *"In all other cases, when the place of use of the Intangible Property by the Final Customer is in [a Jurisdiction].".*

7. Part 2(3) [page 10] clarifies what constitutes a "Reliable Indicator", while Part 2(4) defines what constitutes "Another Reliable Indicator". For this purpose, Part 2(4) refers both to certain rules in Article 5 and requirements in Paragraph 3.

   ICC submits two comments in this regard:
   - Another Reliable Indicator is defined in Part 2(4). However, the draft contains 21 cases where reference is made to "Another Reliable Indicator as defined in Part 2(3)". It seems that in all these cases reference should be made to Part 2(4).

- With respect to Part 2(4), it seems likely that reference should be made to Paragraph 5 instead of Article 5.

ICC therefore recommends checking the reference to Part 2(3) and Article 5.

8. Part 2 -Reliable Method [Page 10], Paragraph 3, b. The section notes that as an "indicator" to determine the source of revenue, it must meet at least one "reliability test". However, the expression of "functionally equivalent" in item IV is not clear and specific enough. Further clarification would be needed for greater certainty and to avoid any potential delays related to agreement between both parties on the selection of the "indicator".

   In addition, according to the revenue sourcing rules of Amount A, in many cases, the revenue source determination of B2B services, businesses would need to obtain information from B2B customers, including the geographical location the customers use the service for (e.g., page 21-H Revenue from Business-to-Business services, Paragraph 2. *"a. Information reported to the Covered Group by the Business Customer on the place of use of the service;"*).

   However, in practice, unless the service is a seller's market, it is difficult to determine the purpose of the customer's purchase. Even if these difficulties are overcome, it is uncertain whether the "functionally equivalent indicator" meets the "reliability test" in the case of unclear terms.

9. According to paragraph 6 [page 11], MNEs need to find their own "reliable indicators" according to the "reliable method". If MNEs are unable to determine a "reliable indicator" after taking "reasonable steps" to identify one, they may use the "allocation key" to determine the source of revenue.

   However, the allocation key is the only solution provided in this case where a reliable indicator cannot be identified. In this regard, can it be reasonably understood that MNEs would select an allocation key to meet the compliance requirements even if there is no corresponding revenue source rule? Furthermore, the reference to "reasonable steps" is not sufficiently specific and could be refined further to enhance certainty.

10. Para 7 [page 11] describes an exceptional situation where the Covered Group must use either the Allocation Key or, in the absence of such an Allocation Key, the Global Allocation Key.

    These situations have been listed in subparagraphs (letters) a-c. However, it is conceivable that these types of situations will only occur in relation to certain jurisdictions, while for other jurisdictions subparagraphs a-c would not be applicable (for instance, because there is a reliable indicator for these jurisdictions, etc).

    ICC recommends adding the following wording (in bold) to the first sentence of para 7, page 11 to make sure that these situations would not be covered under the exception of para 7, and the mandatory application of the (Global) Allocation Key:

    *Notwithstanding paragraph 6,* ***and to the extent*** *where:*
    [..]

11. Part 2 Para 8 [page 12] states that a Covered Group must demonstrate that its internal control framework ensures that a Reliable Method is used in accordance with this Part.

    It is recommended to add specific language to clarify in the Commentary to ensure that:
    i. facts and circumstances can be taken into account when assessing this requirement, and
    ii. less substantial issues or shortcomings will not have the (unintended) consequence/result that the requirements of para 8 would be deemed not to be met.

    ICC further recommends adding the following wording (in bold) to the first sentence of para 8:

    *"A Covered Group must* ***be able to sufficiently*** *demonstrate that its internal control framework ensures that a Reliable Method is used in accordance with this Part."*

12. Para B(3)(b) [page 13] indicates that all (remaining) tail-end revenue will be allocated to low Income jurisdictions, unless the Covered Group demonstrates that Revenues did not arise in <u>any</u> Low Income Jurisdiction.

    ICC submits that there could be questions on how to address situations where tail-end revenue did <u>not only</u> arise in low Income jurisdictions. A literal application of Para B(3)(b) could lead to the conclusion that <u>all</u> tail-end revenue needs to be allocated to low income jurisdictions. This would represent an unbalanced outcome, potentially even an over-allocation to low income jurisdictions (even after application of the knock-out rule of para B(5)) in cases where it is clear that tail-end revenue did <u>not only</u> arise in those low income jurisdictions.

    ICC recommends adding the following wording (in bold) to the Para B(3)(b), page 13 in order to ensure a more balanced result:

    *"In the event* ***and to extent*** *that the Covered Group demonstrates that Revenues did not arise in any Low Income Jurisdiction, the Tail-End Revenues shall be treated as arising in [a Jurisdiction] using the Global Allocation Key."*

13. Para B(4) [page 13] provides that the Covered Group must take reasonable steps to reduce the size of the Tail-End Revenues [5% max]. Footnote 16 indicates that there will be provisions on non-compliance.

    It seems that [5]% is rather low, in particular when a Covered Group is predominantly active in developing countries. ICC suggests that it may be preferable to first gain further experience with the practical application of this particular requirement. In this regard, ICC recommends removing this requirement, or include a higher percentage (15%, for instance) until further experience is gained with the practical application of this particular requirement.

    ICC also recommends clarifying in the Commentary that this does not include any "Non-customer Revenues", which can be deemed to arise in a jurisdiction in relation (proportion) to certain revenues, including Finished Goods (see for instance Page 25, Part 9) for the avoidance of doubt.

ICC members hold that reducing the tail-end revenue may require MNEs to make overall adjustments at group level, which could entail substantive administrative burden and the potential for bilateral or multilateral tax disputes. In this respect, it would be useful to provide supporting measures and a protection period for MNEs for the adjustment of tail-end revenues.

14. Para 4 (A), [page 15] Revenue source rules related to components.
    According to Part 4, the revenue source rules of "components" are determined by the delivery place of "finished goods" assembled by them. According to the draft rules, if a reliable indicator is not available for the sale of components, then the Global Allocation Key will be used.

    In the case of manufacturing industries (e.g., vehicles), the production of parts and components involves multiple [non-related] parties and a complex supply chain before assembly of the final product. Many MNEs will reduce compliance costs in the future and only use the "global allocation key" to determine the source of revenue of "components". In addition, some products can be used as "components" or "finished goods" (e.g., tires). Therefore, in order to determine the attributes of the products they sell, MNEs may need to know the purpose for which customers purchase the products.

    Although the revenue source determination rules are the same for components sellers and independent distributors selling finished goods, there are differences between the two when MNEs cannot determine an indicator. As "components", MNEs will need to apply the "global allocation key". However, as "finished goods", it is possible to apply regional allocation keys or low income jurisdiction allocation keys.

15. Part 5, [page 2–] - Customer Reward Programs, E (1) indicates that Customer Reward Program Revenues are divided by the proportion of Active Members.

    ICC members believe that the above allocation may distort the revenue sourcing if the revenue has a strong correlation with the units owned by the Active Members. ICC suggests that it could be helpful to illustrate different scenarios of Customer Reward Program Revenues. In some cases, using the units on the Active Members' accounts as an allocation key may be more appropriate.

16. Determination of Business to Business (B2B) Service [page 22]
    By definition, a "large business customer" is a group entity whose customers meet the country-by-country reporting submission threshold. If the business providing B2B services determines that its customer is a large business customer, it needs to use the "Headcount Allocation Key" or "Aggregate Headcount Allocation Key" to determine the distribution of its income in each jurisdiction. Businesses should not be required to obtain additional information from customers that they do not already have in the ordinary course of business. The Aggregate Headcount Allocation Key is highly complex and would be very difficult to administer for both taxpayers and tax authorities. These allocation keys require data disclosed in the report submitted by the customer. ICC members note it is not possible to obtain customer country-by-country data.

    At present, not all countries have completed the legislation and global exchange of country-by-country reports in accordance with BEPS Action Plan 13.
    If appropriate, the Global Allocation Key should be permitted to be used by companies.

Additionally, Footnote 47 states that reasonable steps could require the Covered Group to ask the Business Customer if it meets the definition of a Large Business Customer. This would create an undue burden on both the business providing the service and the Business Customer given the large numbers of Business Customers, which are not themselves required to provide such information. This should therefore not be included as a reasonable step.

17. Part 10 – Definitions [page 26] provides a definition of "Allocation Key". The Draft has provided guidance as to the circumstances for particular allocation keys to apply. However, ICC respectfully suggests that it would be useful to include supplementary guidance on how to address possible cases where multiple allocation keys may be applicable.

18. Part 1 "Categorising transactions" [page 27] provides further clarifications with respect to the categories "Main Transaction" (12) and "Supplementary Transaction" (13).

    For the latter, it is stated that the gross receipts should not exceed [5]% of the total gross receipts from the Supplementary Transaction(s) and Main Transaction(s) combined.

    It seems that [5]% is rather low, in particular when more than one Supplementary Transaction(s) takes place. ICC recommends removing the [5%] requirement, or include a higher percentage (for instance, 25%).

19. Part 5, Para 31, [page 30] provides the definition of "Customer Reward Program" which indicates that these may include marketing programs where the Covered Group sells units to third party Business Customers for award to mutual Customers.

    The correlation between Active Members of a Covered Group and its selling units to third party Business Customers may not be strong. ICC suggests that, where appropriate, for revenues from Business Customers, the revenue sourcing rules should be consistent with the guidance provided under Part 5 H.

20. Part 5 – Services para 36 [page 30] – states "If the total invoice amount for services provided to a Business Customer does not exceed EUR [1-3] million in the Period, the Covered Group may treat the Business Customer as not being a Large Business Customer".

    Footnote 47 further explains that if the invoice amount for services provided to the Business Customer exceeds EUR [1-3] million in the Period, reasonable steps could require the Covered Group to ask the Business Customer if it meets the definition of a Large Business Customer.

    In this respect, it is noted that the Covered Group could be expected to undertake online research to review the financial statements of that Customer and whether such statements reflect consolidated group revenue exceeding EUR 750 million. In addition, once CBCR data is made publicly available in EU jurisdictions, a Covered Group would be expected to check whether the business customer has made such information publicly available.

Given the potential administrative compliance burden (combined amount of invoices), ICC recommends including a relatively high threshold (at least 3 million – preferably higher e.g., 10 million, or a safe harbour of the top 100 customers) in the Period.

21. Part I- Government Grants [page 34] provides a definition, however ICC suggests providing further explanation and examples, particularly with respect to "subsidies, grants and refundable credits".

22. Part 9 – Non-customer Revenues [page 34]. It is noted that the allocation of Non-customer Revenues will be determined in proportion to the other Revenues arising under paragraphs 5 – 11, which appears reasonable and provides administrative simplification. However, ICC submits a further comment for consideration: as in certain countries and according to applicable accounting rules, the revenues falling under this category may not be a part of group consolidated revenue. As such, further clarification would be useful in this regard.

ICC remains committed to providing knowledge and expertise on behalf of the global business community.