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Comments on the Public consultation document: Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing

FAR, the institute for the accountancy profession in Sweden, takes the opportunity to respond to the Public consultation document: Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing

Introduction

On February 4th OECD sent out the "Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing" for public consultation. The deadline for delivering comments is already the 18th of February. A time frame that could be questioned especially regarding the quality of the comments. It should also be noted that these comments are based solely on the draft sent out for public consultation. All other aspects of Pillar one Amount A have been disregarded.

The goal of the project is to create rules which will exist alongside the current international tax rules and the aim is to tax big multinational entities with high profits. The draft that is sent out is difficult to form an absolute opinion about since it is, as stated, a high level draft. Thus, it is a challenge to comment on it regarding both the current nature of the draft and the future changes that might be made. The timeframe from draft until implementation is short and there is a high risk that the set of rules are considered rushed. Below are the main points that needs to be addressed in order to improve the draft in a satisfactory way.

The administrative burden for the companies having to handle two different systems

For companies included in the scope of the draft ("in-scope MNE") there will be a completely new in parallel systems for them to adapt to and comply with. The burden of doing this could be substantial partly because of the short period of adjustment, partly because of the uncertainties of the draft. Amount A will be implemented through a Multilateral Convention (MLC), and where necessary by way of correlative changes to domestic law, with a view to allowing it to come into effect already 2023. This means that the in-scope MNEs in near time had to build or adjust the administrative systems, which probably will be impossible for most of them.

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In short, the in-scope MNEs are first required to categorize a transaction according to what category of revenue that is earned from that transaction. Second, the revenue should be sourced using a Reliable Indicator. If the MNE is unable to obtain a Reliable Indicator after reasonable steps has been taken, one of the allocation keys can be used. What is considered "unable to obtain" or "reasonable steps" is supposed to be clarified in the Commentary. Until then, the in-scope MNEs won't be able to know for certain what the different terms mean.

The level of administrative burden is unsure at the moment but can be assumed to be quite large for the in-scope MNEs. Especially considering the number of steps the MNE must take to establish the source of revenue. If the MNEs doesn't comply with the new rules they will receive significant fees. This might result in the use of significant resources so that the MNE are certain they comply with the new rules. There should be noted that MNEs already invest a lot of resources in complying with the existing tax rules and the consequences for the in-scope MNEs could therefore be substantial. It can be questioned from a competitive standpoint since in-scope MNEs will need to spend time and resources to make sure they comply with the new rules. This will surely affect various kinds of in-scope MNEs in different ways which could question how fair the rules are.

The extent of the future administrative burden, as stated above, is difficult to establish. However, it is obvious that the difficulty in rearranging an organization in accordance with the rules is not an easy task and it will most certainly be a challenge regardless of the size of the in-scope MNEs. The draft also contains an evaluation after a period of time with the addition that the scope might get broader. To go in that direction might be even more questionable since the cost for complying with these types of rules will be harder to manage the smaller the entity is.

To ensure that the proposed rules isn't too big of a burden for the in-scope MNEs or Tax administration it is of importance that there are simplifications added to the rules. A good example of this is the nexus threshold. An addition of more rules of the same kind could ease the administrative burden without eliminating the purpose of the proposed rules.

Evaluation of the draft

Overview

The need of clarifications and simplifications is essential for the new system to function and it is therefore problematic that it is unclear how the rules will affect certain companies. The implementation seems rushed considering sufficient time must be given due to the complexity of the rules.

While the Draft Model Rules eliminate the strict hierarchy of indicators from the 2020 Blueprint, there will be many straightforward cases when it will be obvious which indicator should be applied. However, it is unclear what types of alternative indicators may be used if an identified indicator is not available. Moreover, while the rules acknowledge that information about end-market sales may not be readily available for certain categories of revenue (e.g., sales through third-party distributors, sales of components, certain B2B services, and certain IP), the rules generally require an MNE to take "reasonable steps" to identify a Reliable Indicator before resorting to one of the specified allocation

keys. It is not at all clear what is expected in terms of attempts by an in-scope MNE to obtain information from their B2B customers in these circumstances.

Reliable Indicators

In the draft it is suggested that an indicator that has a non-tax purpose is reliable. A questionable aspect is that an indicator is seen as more reliable if another indicator provides the same answer. How reliable the indicators, that support another indicator, needs to be is something that needs clarification in order to function properly. In addition, the need for a non-tax use as a prerequisite to relying on a single indicator is surprising, given that the rules will in many situations require MNEs to take reasonable steps to collect new information from B2B customers purely for tax purposes, and the MNE will have no reason to know how its customers use that information. Thus, it is unclear whether the reliability test would be satisfied if the MNE modified its business to gain access to an indicator in order to comply with the sourcing rules.

Allocation Keys

The Draft Model Rules are ambiguous on the degree of certainty an MNE must have in applying the Knock-out rule. While the rule is described as allowing the MNE to make reasonable assumptions, the examples of the scenarios in which the Knock-out rule would apply indicate that some degree of actual knowledge is required to support the assumption. This must be clarified in the commentary.

The Draft Model Rules appear to require the use of an allocation key for MNEs that do not take reasonable steps to identify a Reliable Indicator, even if failure is intentional. While this result would be contrary to the policy objective of the revenue sourcing rules, there would seem to be no alternative in this case. The Draft Model Rules refer to work on the administration of Amount A, including the development of penalties for non-compliance. The potential for penalties in certain circumstances further highlights the need for clear guidance on what will be considered “reasonable steps”.

It appears that the lead tax administration for an MNE would be able to determine the MNE’s use of a particular indicator without the need to reach consensus with other tax administrations. It is therefore not clear how the assessments done by the different tax administrations will affect the companies’ use of indicators worldwide.

Concluding remarks

A certainty, regardless of how the system would be implemented, is that it would be in dire need of evaluation. This should mainly have the focus of how the implemented rules have worked rather than how the rules could be expanded further. The pace of which these rules are implemented is unprecedented and therefore it is difficult to know what the implications might be, both for businesses and jurisdictions. It is important to have in mind that the pros of the rules must outweigh the cons.

The number of uncertainties in the rules are also a red flag to consider. The in-scope MNEs will be fined greatly if they do not comply but considering that the rules are unclear to many legal professionals it is not easy for a MNE to be sure that they interpret the rules correctly. A commentary could sort out some of these issues but the uncertainty in deciding on the implementation of rules

without knowing what they actually mean is at the least questionable. With the Commentary available along each step of the way would make the process more transparent and fairer for every party affected by the rules, companies, and jurisdictions alike. Instead, there are now a lot of references to the Commentary which means that no preparation can be made before the actual Commentary has been released. This poses a great risk since several of the phrases that are supposed to be clarified through the Commentary is what the entire drafts relying on to work properly.

Yours sincerely

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