The **BEPS**

Monitoring

Group

COMMENTS ON PILLAR ONE -
TAX CERTAINTY FOR ISSUES RELATED TO AMOUNT A

These comments by the BEPS Monitoring Group (BMG) respond to the public consultation document issued by the OECD Secretariat on behalf of the Inclusive Framework on BEPS, on the proposed Pillar One Amount A Tax Certainty Framework. The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. This report has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. It has been drafted by Jeffery Kadet and Sol Picciotto, with contributions from Abdul Muheet Chowdhary and comments from Tommaso Faccio.

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Summary

The best way to achieve certainty for allocating the rights to tax the profits of multinational enterprises (MNEs) is to formulate rules that are clear and simple, and in line with the business reality that they operate as unitary global enterprises. This is achieved in the design of Amount A in Pillar One, for which certainty can be ensured through an essentially administrative coordination process. This will deal with all the issues of definition and allocation of Amount A, including avoiding any double taxation.

Regrettably, however, Amount A has been designed as an exception, applicable only to a small part of the profits of around one hundred of the largest and most profitable MNEs, so that the existing rules on transfer pricing would continue to apply in all other cases. These rules are highly complex and rely on subjective judgments, and inevitably generate conflicts. These concern often highly contentious issues, particularly when they involve claims by host countries to tax more than the 'routine' profits from the local activities of foreign-based MNEs. Yet it is these very disputes to which this proposed procedure would apply for MNEs in scope of Pillar One.

The proposal would require any unresolved conflict to be referred to mandatory supra-national arbitration through a Panel, the majority of members of which would be business tax advisers. This is a fundamental abdication of state sovereignty, entrusting decisions involving often large amounts of government revenue to unaccountable private practitioners, who would operate in total secrecy, and provide no explanation or rationale for any decisions made. These proposals are totally inappropriate and unnecessary, and their inclusion would make it even more unlikely that many states will adopt Pillar One. In our view, since

international tax disputes are between states, and concern important issues affecting government revenue, they should be settled only between governmental representatives.

A. General Comments

We welcome this opportunity to comment on these important proposals, and hope that our comments will be helpful, despite the very short period allowed. We are also considerably hampered by being provided here with only a part of the jigsaw of the Pillar One scheme. Although some of the other parts have been released for comments, many have not. We also lack an overview of the whole picture, and how it may differ from the last full version published in the blueprint of October 2020. Perhaps the negotiators are also similarly hampered.

The best way of achieving tax certainty is to formulate rules (i) that are simple, clear and objective, and (ii) that reflect the overarching principles that govern Pillar One. The overarching principles must be articulated clearly and be understandable to all. Where this is the case, taxpayers and tax administrations will know that their applications of specific rules should be acceptable.

The design of Amount A is a major step forward in regard to certainty since it uses an objective formulaic method to allocate a portion of the global consolidated profits of multinational enterprises (MNEs) amongst market jurisdictions. This contrasts starkly with the current rules for allocating MNE income, which require an examination of the facts and circumstances and an analysis of the functions, assets and risks of each affiliate or permanent establishment within an MNE corporate groups, all dependent on subjective judgments. These ad hoc and subjective rules have inevitably generated disagreement and conflict, and will continue to do so in the future.

Pillar One has now been designed to apply to a very small number of the very largest and most profitable MNEs, likely one hundred or fewer in total. It would apply an exceptional system to a small number of MNEs, and for only a small part of their profits, while retaining the existing defective rules for all other purposes; hence, the continuance of disagreements and conflicts. The creation of such a separate and distinct regime, while trying to splice it into the current rules, creates problems of both principle and practice. These are most prominent for the 'issues related to Amount A', which we address in this submission.

1. The Definition of 'Issues Related to Amount A'

A very broad definition is proposed for the scope of Related Issues in draft Article 19.1. It appears to cover *any* adjustments to the profits of a transaction involving an affiliate or permanent establishment of a multinational enterprise (MNE) Group in-scope of Pillar One. The proposed procedures would thus apply to any complaint by an in-scope MNE relating to 'taxation not in accordance' with an Existing Tax Agreement, even if the transfer pricing or profit allocation issue has nothing to do with Pillar One. Paragraph 1 of the Commentary makes this clear by saying:

> 'Paragraph 1 of the operative text defines the scope of application of the dispute resolution mechanism provided for in Section 3 through the definition of "Related Issue". Pursuant to this definition, the dispute resolution panel mechanism is available with respect to *any MAP case* that concerns a *transfer pricing adjustment* to a transaction between members of a Covered Group, or to the *profits attributed to a permanent establishment* of a member of a Covered Group.' [Emphasis added.]

A separate 'tax certainty' mechanism has been provided for the calculation of Amount A in the companion Public Consultation Document concerning 'A Tax Certainty Framework for

Amount A'. The scope of this mechanism includes deciding whether an MNE is within the scope of Amount A, the calculation of Amount A, the allocation of payments of Amount A, and the elimination of double taxation. Hence, the procedures in this separate proposal covering 'Related Issues' would apply to disputes completely outside the scope of Amount A, beyond even questions about whether the allocation of Amount A has created double taxation.

As indicated above, Amount A is a separate and additional layer of taxation using a global formulaic approach that is added on top of the existing tax framework that is based on the separate entity concept. With the global calculation of Amount A and its allocation to market jurisdictions being covered by the companion Public Consultation Document, it is clear that Amount A is intended to reallocate a defined proportion of the 'residual profits' of in-scope MNEs to jurisdictions where they have sales. These residual profits are considered as more-than-routine profits, defined as those above a specified rate of profit-before-tax in relation to revenue. This broad definition of 'Related Issues' therefore covers Amount A not at all. Rather, it covers solely matters that will normally not affect Amount A in any way. As a result, it effectively requires any jurisdiction that signs onto Pillar One (aside from the few to which an 'elective binding dispute resolution panel mechanism' would apply) the binding obligation to use for in-scope Groups the 'last-best offer' or 'baseball' arbitration model.

The intention seems to be to ensure that this model of arbitration is required for all disputes that involve claims by a host jurisdiction to tax more than mere 'routine' profits on the local operations of an in-scope MNE. These issues are among the most contentious and dispute-prone issues in international tax today. They include, for example, whether super-normal profits can be attributed to location-specific advantages, what constitutes the 'control' of risks and what compensation can be attributed to it, whether and to what extent inter-affiliate transactions can be recharacterised or disregarded, the allocation of ex-post returns on intangibles, and the application of the DEMPE framework to the allocation of returns to intangibles. These uncertainties remain even after the changes to the OECD Transfer Pricing Guidelines resulting from the BEPS project.[1]

These issues of course affect the allocation of profits under tax treaties for all MNEs, not only those in-scope of Pillar One. Decisions on income allocation taken under these proposed procedures will inevitably have spill-over effects for conflicts concerning non-in-scope MNEs. Although the decisions would be confidential to the parties concerned, they would be known to the Competent Authority personnel in the two countries concerned, as well as the in-scope MNEs' tax advisers. This will inevitably create an expectation to apply the same standards in similar disputes for out-of-scope MNEs, whether or not there are arbitration procedures in the applicable bilateral tax treaties.

Thus, by extending the system of arbitration beyond what is needed for Amount A, these provisions would require states which may wish to participate in Pillar One to accept that the highly contentious issues of allocation of MNE income would be determined by arbitration.

One other aspect to consider is that this requirement to use 'last-best offer' arbitration for in-scope MNEs will mean that the ultimate arbitration result may differ markedly from the result that might be achieved had there been no 'last-best offer' procedure for the two Competent Authorities to fall back on. Where a non-in-scope MNE is involved and the applicable tax treaty does not provide for arbitration, the two Competent Authorities are under more

[1] For an authoritative analysis of the many areas of uncertainty see Joseph Andrus and Richard Collier. *Transfer Pricing and the Arm's Length Principle after BEPS.* Oxford University Press, 2017.

pressure to arrive at some compromise that reflects the facts of the taxpayer group and the applicable tax laws governing the transactions at issue. This means that where an in-scope MNE and a non-in-scope MNE have comparable situations, the tax treatment and relevant tax payments to each state will be different. This is because for the in-scope MNE, the two Competent Authorities can choose to side-step the difficulty of reaching agreement on a contentious issue and let it be settled by the 'last-best offer' arbitration procedure. On the other hand, for the non-in-scope MNE, the two Competent Authorities must work to an agreement or agree to disagree. This creates a relatively stark unequal treatment between in-scope MNEs and non-in-scope MNEs, which is not consistent with good tax policy.

2. The Extension of Arbitration to Jurisdictions not covered by an Existing Tax Treaty

This discussion draft envisages that these procedures would apply between participating states even if they have not agreed an existing bilateral tax treaty (paragraph 2(a)(i)). To enable this, the multilateral convention would itself include '*substantive transfer pricing and profit allocation rules'*. A footnote indicates that this has not yet been agreed, and it is only 'a placeholder for a reference that may be required for the technical operation of the provision'.

We are not surprised that the proposal is considered by some states to be unacceptable from a policy perspective. But it also raises a host of technical issues. Tax treaties allocate tax rights over international business through a range of provisions and relevant definitions. We find it hard to understand how transfer pricing and allocation rules that operate within the context of a complete bilateral treaty that of course includes the full range of provisions and relevant definitions could be included in isolation in this proposed convention. As just two obvious examples of this, the Articles 4 and 5 definitions of 'resident' and 'permanent establishment' would often be critical to any application of transfer pricing or profit allocation rules to an MNE's group members. The treaty rules themselves (Articles 7 and 9) provide only the bare basic principles. Their application in practice follows the OECD Transfer Pricing Guidelines, which are given a status for interpretation by reference in the Commentary to the Model Tax Convention. There would presumably need to be a similar reference in the Commentary to this convention. Yet, it is the major flaws in the OECD approach to transfer pricing that have created the problems that the BEPS project was supposed to resolve.

The suggestion to import OECD practice as well as treaty rules on transfer pricing and profit allocation into this multilateral convention seems highly problematic in both technical and policy terms.

3. The Unsuitability of 'Baseball' Arbitration for the Allocation of MNE Income

The use of arbitration to resolve international tax disputes has been opposed particularly by developing countries, in our view rightly. The central reason for this is that it is contrary to state sovereignty. This point is worth spelling out. States can of course freely enter into international agreements to resolve disputes between them, and this is highly desirable. However, an agreement that disputes between them regarding specified issues should be resolved by external arbitrators is a very different matter. It creates a supra-national procedure to resolve the specified issues. It is very rare for international treaties to include such a provision, especially one that is mandatory and binding.

Here, such a mandatory and binding procedure is proposed in relation to complaints that can be brought by legal persons (MNE affiliates). This has the effect of allowing MNEs access to a supra-national procedure as an alternative to national courts, if they prefer it. The supra-national decision would have precedence and must be applied, unless it is found to be invalid under purely procedural grounds by a national court (paragraph 5(b)(ii)).

A similar procedure has also applied, for a much longer time, in bilateral investment agreements (BITs). This similar procedure is termed an investor-state dispute resolution system (ISDS). The experience of ISDS has proved deeply unsatisfactory for virtually all states, creating a ferment of reform initiatives. It has been particularly damaging for low-income countries, because arbitration decisions involve often substantial financial penalties that they can ill afford. More widely, they impose a chill on the state's freedom to regulate foreign-owned business in its own economic interests. It reinforces the enormous economic power of large MNEs by giving them enforceable rights outside and above national law.

One of the main drivers of the BEPS project has been widespread public concern about the ability of MNEs to avoid tax under current international tax rules. The various recommendations and decisions taken as part of the BEPS process have attempted to remedy this. However, agreement has still not been reached, despite the years of negotiations, on many of the key issues affecting the allocation of MNE income. Yet it is precisely these issues that the proposed procedure would hand over to a mandatory binding procedure.

Furthermore, the proposed procedure is in several respects even more inappropriate than ISDS. International tax disputes are treated as totally secret. Even the existence of a dispute is expected to remain confidential. Normally, international arbitrations involve reasoned decisions evaluating the arguments of the parties and explaining the basis of the decision. Here, under the Public Consultation Document, a reasoned decision is not permitted. Instead, the arbitrators must choose between the proposals put forward by the two sides, focused on a monetary amount with no ability to explain any reason behind the decision made.

The inclusion of these provisions would in our view make it even more unlikely that many states will ratify a multilateral convention for Pillar One.

B. Specific Comments

1. Composition of Dispute Resolution Panel

There are divergent views among Inclusive Framework members as regards the composition of the dispute resolution panel. Footnote 7 on page 14 notes:

> … One group of jurisdictions are of the view that the panel should comprise of independent experts only to allow an independent decision on issues that remained unresolved between the governments in MAP. Another group of jurisdictions feel that the panel should comprise of government experts only …

In our view, since international tax disputes are between states, and concern important issues affecting government revenue, they should be settled only between governmental representatives. As explained below, 'independent experts' will seldom, if ever, be truly independent. Their lack of independence will without question colour and bias dispute resolution panel findings.

Paragraph 16 as drafted presents a mixed panel as a compromise. However, this is far from the case. The criteria for 'experts' in paragraph 16(g) require only that they should not be working for governments. Hence, these 'experts' will of necessity be primarily business tax advisers, even if they may previously have worked for a government. (Academics could also qualify as 'experts'. However, the condition in 16(g)(ii) that they must have a specified number of years of 'relevant experience in dealing with corporate tax matters' will mean that few of them would qualify since most will not have worked as business advisers). Furthermore, the Chair of a Panel would also be chosen from among these experts. Thus, the two government members, one from each side of the dispute, would be in effect only observers, or perhaps advocates for their government's position.

The criteria for non-inclusion of an expert in a particular Panel relate mainly to whether the person has a specific conflict of interest.

2. Existence of Conflict

Under paragraph 16(f)(ii)(A) and 16(f)(iii), an expert can be conflicted as to a particular Covered Group. While we agree with this five-year restricted period, this rule that focuses on only a particular Covered Group is simply not sufficient. Even if an expert is not a paid consultant for a particular MNE Group that is the subject of an issue that is being presented to a dispute resolution panel, that individual will be judging issues that will be important to other MNEs to which they have provided advice and counsel in the past and could continue to do. They are not truly or sufficiently 'independent'. Only otherwise qualifying individuals who have ceased providing any services for MNEs for an extensive period, such as a minimum of five years, can be considered potentially 'independent'.

It should be added that paragraph 16(f)(iii) is far too narrow. It should not be limited to those 'involved in providing tax services or accounting/audit services'. Rather, this should include providing any services for an MNE.

In addition, paragraph 16(f)(ii)(B) specifies that there is a conflict where the individual is a 'Significant Investor' or has 'Significant Business Dealings'. Given the strong need for true *independence in both fact and appearance*, it is absolutely critical that there be a defined conflict in the event of *any* investment or business dealings. This must be changed.

3. Chair of Dispute Resolution Panel under Mixed Option

Paragraph 16(a) provides for five members, three of which are independent experts and two of which are from the staff of the two Competent Authorities. One of the independent experts must be appointed as the Chair.

This dispute resolution panel process should not be seen as something that is controlled by non-governmental individuals. In addition, such individuals will seldom, if ever, be truly independent. Accordingly, paragraph 16 should be recast to provide for the Chair to be an independent government official from a jurisdiction other than those of the two Competent Authorities. The Chair, of course, would have to be acceptable to both of those Competent Authorities.

4. Need to Move Away from MAP Proceedings Being Confidential

We recognise that current conventional wisdom is that all MAP proceedings should be treated as secret in every respect; even their existence is usually considered confidential to the parties concerned.

However, we strongly believe that in virtually all MAP-related situations, including where 'the last-best offer decision-making model' is used, the worldwide tax administration process would be significantly improved and more useful to all tax administrations and taxpayer groups from proper disclosure of proceedings, and particularly the rationales for the decisions of the dispute resolution panels. This would help to ensure more consistent decisions on similar issues, and create greater predictability and certainty, thus reducing the number of disputes. This is abundantly true for publicly available court decisions (where of course there is often legal precedential value), and would be the same for MAP proceedings (even without legal precedential value, which is confirmed in paragraph 28(j)). With this in mind, we encourage the Inclusive Framework to reconsider this matter.

Paragraph 28(g) reads in part:

> The dispute resolution panel shall select as its decision one of the proposed resolutions for the case submitted by the Competent Authorities with respect to each Related Issue and any threshold questions, *and shall not include a rationale or any other explanation of the decision*. … [Emphasis added.]

We understand the efficiency that arises from use of 'the last-best offer decision-making model'. However, to specifically prohibit including any rational or explanation of the decision means that any opportunity for the further development of taxation principles and application is totally forgone. We urge that such MAP decisions should be publicly available. However, even if decisions remain confidential to the participating Competent Authorities, there is real value for these Competent Authorities to know how and why a particular decision was made. Such information will be important to their increasing sophistication and use in future MAP proceedings.

We also note paragraph 27(a)(iv), which provides:

> The dispute resolution panel proceeding with respect to a case shall terminate if … any member of the Covered Group or any of its authorised representatives or advisors breaches the written confidentiality agreement required by paragraph 19.

Given that there appears to be no public reason for the Competent Authorities of the Contracting Jurisdictions to be concerned about confidentiality if the Covered Group is not so concerned, it seems inappropriate to provide for automatic termination of the dispute resolution panel proceedings where the Covered Group or its advisors have caused the breech. We suggest that paragraph 27(a)(iv) be deleted. Note that any such breach that discloses otherwise confidential Covered Group information or data will not be cured by a termination of the dispute resolution panel proceeding. Additionally, if proceedings are continued even after a breach, the confidentiality rules mean that no further information or data will be released.

We note that the introductory material in paragraph 28 states:

> Except to the extent that the Competent Authorities of the Contracting Jurisdictions mutually agree on different rules, the following rules shall apply with respect to a dispute resolution panel proceeding pursuant to this Article [28] …

Since this allows agreement on different rules, the Competent Authorities of the relevant Contracting Jurisdictions could choose either (i) an open MAP process, and/or (ii) for the dispute resolution panel decision to specifically include applicable rationales and explanations for the decision. Given the many benefits of a more open MAP process and understanding the background to decisions, we suggest that some guidance be provided regarding how a more open MAP process would work if the relevant parties agree on that alternative route. Providing a more standardised framework and procedures for such an alternative would be beneficial to all.

In regard to this ability to agree on different rules, it should be noted that there is only one provision in paragraph 28 that must apply notwithstanding any alternative rules adopted by the relevant Competent Authorities. This is paragraph 28(j) regarding the condition that the dispute resolution panel decision must have no precedential value.

5. MNE able to file MAP Request before Either Jurisdiction

Paragraph 1 of Article [X] (Mutual Agreement Procedure) allows a member of a Covered Group to file a MAP request with either Contracting State, referencing Article 25 of the OECD Model. This is something many countries, especially developing countries, have expressed concern with, as the same provisions also exist in the OECD BEPS MLI. Many of these countries have chosen not to apply this provision and have expressed reservations. Accordingly, this option should be removed or at the most be consistent with Article 25(1) of the UN Model Tax Convention where the person should only be able to file a MAP request in the State where he is a resident.

We believe that this ability for an MNE to choose the country to which it will request Competent Authority relief is a flawed approach particularly because it allows ‘forum shopping’. In other words, MNEs may simply chose to request relief from the country that they believe will give them the most receptive hearing, and ultimately a better resolution. This is not good tax policy.

6. Costs of Dispute Resolution Panel Proceedings

The overall approach of Article 19 and Article 20 is that costs are born by the two countries and not by the MNE group member that has requested Competent Authority relief. We understand that the rules set out in paragraph 30(a) of Article 19 generally follow paragraph 8 of the ‘Mutual agreement on the implementation of paragraph 5 of Article 25’, which is included in the Annex within the OECD Commentary on Article 25 of the OECD Model Tax Convention.

We understand that this approach of all costs being borne by the two countries makes good sense where the two countries have ratified and put into effect a bilateral tax treaty between them that includes a standard article on a ‘mutual agreement procedure’, with or without a provision for an arbitration process. In such a case, both countries have specifically agreed to a clear mechanism for resolving disputes, presumably knowing at the time of the negotiation of the treaty the principal business and investment activities that are occurring between the two parties to the treaty.

In contrast, Articles 19 and 20 would subject each country that signs on to Pillar One a requirement to receive requests for the dispute resolution panel procedure from relevant in-scope MNE members conducting business or investment with any other country that has similarly signed on to Pillar One. This of course includes instances where there is no bilateral tax treaty between the two relevant countries. This is simply not the same situation as occurs when a normal bilateral tax treaty is negotiated and ratified.

With this difference in mind, we believe that all costs of this dispute resolution panel mechanism must be borne through user fees by the applicable MNE member and not by the two Competent Authorities. The limited ability to collect costs related to a dispute resolution panel specified in paragraph 30(b) of Article 19 is not sufficient.