CBI RESPONSE

OECD PUBLIC CONSULTATION DOCUMENT – SECRETARIAT PROPOSAL FOR A "UNIFIED APPROACH" UNDER PILLAR ONE

Published: 9 October 2019; Closing dates for comments: 12 November 2019

Background

As the UK's leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce in the UK, covering the full spectrum of business interests both by sector and by size. Members include those in the new "digital economy" as well as more traditional businesses.

We welcome the progress the OECD has made on this matter and the opportunity to provide input into your policy making process on proposals to address the tax challenges arising from the digitalisation of the economy. We continue to support the OECD as the right body to lead reform in this area. Businesses, and the millions of customers they serve, need to have a stable and consistent framework for raising tax in a broad based and non-distorting fashion in the many jurisdictions in which they operate. In light of the complexity of the issues at hand, the OECD "Unified Approach" represents an important step forward, albeit we recognise that there remain a number of challenges to be addressed.

We have structured our response to set out initial comments on the consultation before responding to questions raised within the document. We have taken this approach because we believe there are some overarching points in relation to the proposal, which should be considered prior to delving into the specific detail.

If you have any questions or would like any further detail, please do not hesitate to get in touch. We look forward to continuing to work with you as your work in this area progresses.

Key points

1) Dispute prevention and resolution measures

It is of fundamental importance for all our members that an international consensus must be reached which ensures that firms are subject to taxes which equate to only taxing their profits, not revenues, once. For every £1 of profit that is allocated to a market country, there must be an equal and opposite adjustment by another country to relinquish taxing rights over the same profits. This is critical to ensuring there is not double (or multiple layer) taxation.

To achieve this, and in recognition that the proposal brings further opportunities for disputes to arise, it is critical that incorporated within this proposal is a requirement for all jurisdictions to sign up to enhanced dispute prevention and resolution mechanisms. These should include mandatory binding arbitration, alongside a move towards the centralisation of dispute resolution processes (for example through a One Stop Shop) to speed up the resolution of disputes which are expected to span multiple countries.

Furthermore, an important part of dispute prevention will also be the commitment by countries to repeal (and not introduce new) unilateral measures which seek to increase their tax base (such as Digital Services Taxes and Diverted Profits Taxes) and lead to increased risks of double taxation.

2) Centralised administration

For this proposal to succeed it will be essential that all economies (regardless of size) can benefit, otherwise further discussions over the allocation of taxing rights are likely to resurface in the near future.

Ensuring that the proposal does not create material barriers to trade will be a critical part of this however, the necessity to define and apply country specific sales thresholds in response will be driven by additional compliance burdens arising as a result of a new nexus. If the upfront administrative design of the proposal can be developed with this in mind, then the need for country specific sales thresholds become less relevant. This will be particularly important for ensuring smaller developing countries receive their allocations of taxing rights.

In our view centralised administration which seeks to minimise the administrative burden of the proposal will reduce the risk stemming from the proposal of deterring businesses from operating in smaller economies - one way of achieving this would be through the operation of One Stop Shop and the centralisation of tax filings and payments.

3) Processes and steps to operate an Amount A allocation

There is a need for further focus on the entity(s) which surrender the Amount A to the market jurisdictions. It is essential that the corresponding reduction in income in the surrendering country is agreed at the same time as any profit is allocated to market jurisdictions – otherwise double taxation will arise, leading to further uncertainty over tax positions for both governments and businesses alike.

We have structured our response to outline those processes and steps which would need to be undertaken in order to operate an Amount A allocation process as follows;

Step 1) Analyse and determine which (if any) business segments are within scope for the purpose of the Amount A provisions.

Step 2) Identify or derive the relevant consolidated account's profit figure or component which is to be used as the starting point for the Amount A allocation (we say 'or derive' as it is not clear that accounts segmentation boundaries will generally match the intended tax ones).

Step 3) Allocate that profit (using whatever mechanics are determined) between a routine profit amount and a non-routine profit amount.

Step 4) Allocate the designated proportion of that non-routine profit amount between the markets served by the relevant entrepreneur in accordance with whatever are the allocation principles determined.

Step 5) Analyse and determine which legal entities are, or may be, relevant entrepreneur entities with an amount to surrender some proportion of the Amount A non-routine profit which is to be re-allocated from resident jurisdictions to market jurisdictions.

Step 6) Attribute or allocate the non-routine profit amount calculated under Step 3 between the relevant entrepreneur entities identified in Step 5.

Step 7) Make any necessary adjustments to the tax returns of the resident entrepreneurs to exclude taxable profits which are to be allocated to market jurisdictions.

Step 8) Make any other necessary adjustments or claims to eliminate double taxation (e.g. withholding tax refunds if reallocated profits have already been taxed in the market jurisdiction via withholding taxes).

Step 9) Make any necessary filings/payments in the market jurisdictions when required.

Not included in this list is the treatment of losses however, this is an area where we strongly consider further work is needed given their importance to business. This will be particularly important in those industries where losses are incurred in relation to R&D spend over a number of years before profits are made - applying Amount A on an annual basis would not reflect this.

Consultation Questions

1) Scope

Providing businesses with stability, predictability and simplicity in the tax system are fundamental principles in promoting economic growth and cross-border trade. Businesses within the scope of this proposal are expected to be significantly impacted, therefore clarity for business over whether they are within the scope (or which part(s) of their business are within scope) will be essential in ensuring these fundamental principles are met and maintaining the coherence of and administrability of the international tax framework.

The first step for any businesses in operating the Amount A proposal will be to;

Step 1) Analyse and determine which (if any) business segments are within scope for the purpose of the Amount A provisions.

1a) Interaction with consumers/users

Whilst the focus of the proposal on consumer-facing businesses is broader in its application than prior proposals which sought to ring-fence the digital economy, such an approach retains elements of ring-fencing and the inherent complexities of defining in and out of scope businesses (or activities within).

The opinion of our members is diverse on whether there should be (and the extent of any) scope limitations however, there is consistency across these views that for the proposal to represent sustainable reform to the international tax system the scope needs to be grounded in policy rationale, which clearly articulates why businesses are in scope – with scope being based on key concepts which can be translated to the business models of tomorrow, not just based on a reflection of business models which exist today.

The need for a clear definition of consumer-facing business

The proposal which is premised on modifying the current profit allocation rules for consumer-facing businesses will require a clear definition of consumer for these purposes and currently there remains significant ambiguity over this definition and whether it will be achievable to provide this. Whilst definitions of "consumer" exist in other areas of law these are anticipated to vary from jurisdiction to jurisdiction and therefore relying on current (and potentially varying) definitions will not provide the much-needed certainty and consistency of application by jurisdictions.

We understand that the definition of consumer-facing businesses is not intended to solely encompass B2C transactions, but there is an intention for there to be specific carve outs for certain industries. However, there remains a big gap between those industries that are proposed to be carved out and those which may be considered consumer-facing businesses – based on the current intended scope, clarity is essential over when the proposal will extend to B2B transactions. Furthermore, we consider that there will be significant difficulties in defining consumer-facing and outline below a number of complex areas which highlight the difficulties and will require detailed consideration;

- ***Extent of material modification*** – for example services/goods are provided to businesses for use in running their business (i.e. as a component for further manufacturing) this would be distinct from a sale to a distributor for simple on-sale (i.e. where no (or immaterial) modification takes place to the good/service before onwards sale). However, the practicality and general applicability of such a test requires consideration of where the line is drawn, particularly with integrated products such as computer chips, software, automobile parts etc that are incorporated by an unrelated party into a new consumer product. This new product will have a name, character and use different from those of all the rest of its constituent materials meaning it has been physically and materially changed through the manufacturing process by unrelated entities. It would also not be feasible in many instances to determine the destination of consumption of the finished product (see below).
- ***Dual market products*** – some products will be both consumer-facing and B2B, for example taking the above automobile parts examples, such products can be purchased by both consumers and businesses. There will be no material modification that differentiates them from being business or consumer-facing in such instances, demonstrating the complexity of the factors that need to be considered.
- ***Business to Government products*** – it will not always be the case that at the end of any value chain is a consumer, this will be particularly relevant where the end user is a governmental organisation, who in many cases will have no “consumers”. Similar scenarios may apply in B2B transactions, where the business customer is using the product/service in their business but not on-selling it to a consumer. It’s not expected that such scenarios (including governmental ones) being within the scope of the proposal would be in line with the concept of consumer-facing.
- ***Ability to determine destination of consumption*** - a correct attribution of revenues between jurisdictions based on where goods/services are ultimately consumed will present challenges, in particular where intermediaries are used, or products are integrated (as outlined above). Expecting companies to have knowledge (or access) to unrelated entities’ supply chains will add significant complexity to the proposal and further consideration should be given to whether any scope which required such a “tracing through” exercise is necessarily linked to the concept of consumer-facing.
- ***Highly regulated industries –*** For some industries, regulation dictates how businesses can operate in jurisdictions. This can include the requirement for a sustained physical presence in the jurisdiction where consumers are located, regulation over prices and prohibition of sales directly to consumers. Such regulation can often lead to profit being required to be recognised in the market jurisdiction through the requirement to have a physical presence, or in those industries where there is a regulation over price or direct sales to consumers it’s unlikely these industries will be able to generate the excess return of greatest concern.

1b) Defining the MNE group

To be simple and transparent, we consider that the MNE Group should be aligned with the accounting rules for consolidation.

1c) Covering different business models (including multi-sided business models) and sales to intermediaries

Further consideration needs to be given to multi-sided business models, particularly where businesses do not report on a segmented basis in line with the intended scope of the proposal, please refer to Section 3c for further detail.

1d) The size of the MNE group, taking account of fairness, administration and compliance costs

A balance is needed between a threshold that recognises the additional complexity and administrative requirement of these rules whilst ensuring that a level-playing field is maintained between businesses.

The €750 million total worldwide revenues proposed which aligns this proposal with the CbCR threshold would bring a significant number of companies within the scope of the proposal. For some of these businesses near the threshold, even where they have high margins, depending on the number of jurisdictions to which residual profit is reallocated this could result in minimal reallocation relative to the effort involved, therefore further consideration of centralised administration to ease the administration burden of this proposal will be essential. Please refer to Section 2b for further detail.

1e) Carve outs that might be formulated

Whilst we understand the political momentum for where we are today, we would draw reference to the need for articulation of clear principles underling why consumer-facing businesses are in scope as outlined in Section 1a above - without this it is difficult to comment on which carve outs there should be.

We would note that clarity will be essential over any carve outs to provide businesses with certainty and should be based on key factors that can apply across business models today but also transcend across the business models of tomorrow.

2) New nexus

2a) Defining and applying country specific sales thresholds

We consider that it will be challenging for many businesses to determine a reliable method of assessing a MNE's sales on a country by country basis where there is no physical presence (e.g. export sales through third party distributors where the sale is recorded in the exporting entity) as this information is not likely to be recorded as revenues against the end market country in the consolidated financial statements (the CbCR only records sales where there is a physical presence). Additional analysis will be required to calculate sales where there is no physical presence which will be an additional administrative burden to taxpayers solely undertaken to meet these requirements.

It will be challenging to compare MNE sales in a country to a sales threshold and it is unclear what metric or data points would be appropriate to determine the size of the market relevant to the MNE's business. For example, it could be determined on general industry data within the country or based on data of deemed competitors operating in the country.

There will also be challenges around consistent sales recognition as different entities within an MNE group may recognise and account for sales in different ways which could potentially impact the sales threshold.

2b) Calibration to ensure that jurisdictions with smaller economies can also benefit

We consider that a new nexus, not dependent upon physical presence, but largely based on sales requires the following to ensure that all economies can benefit equally.

i) ***That the proposal does not create material barriers to trade***; this will be vital in ensuring that all economies (regardless of size) can benefit. Additional compliance burdens arising from the creation of a new nexus are in our view the riskiest factor which could create barriers to trade - new material compliance requirements will be factored into the decision-making processes of business over whether to enter new (or remain in) jurisdictions – this impact is expected to be disproportionately felt in smaller jurisdictions.

Therefore, the necessity to define and apply country specific sales thresholds will be driven by additional compliance burdens arising as a result of a new nexus. However, if the administrative design of this proposal can be developed with this in mind, the need for country specific sales thresholds becomes less relevant. This will be particularly important for the protection of smaller developing countries to receive their allocation of taxing rights.

The potential impact of the compliance burden/local registrations arising from this proposal should not be underestimated, the requirements on business would not just be limited to tax return preparation/filing but could also extend to notional branch accounts, local trade register filings, admin around tax payments, handling of tax authority queries etc. For an MNE that sells its goods/services in 150 countries but currently only has a traditional “nexus” in 50, the additional compliance costs could escalate quickly. There is potential for the tax take in smaller jurisdictions to quickly be outweighed by the compliance costs which may lead MNE’s to reconsider trading in these jurisdictions.

One way to achieve this simplified administration - which we consider would be beneficial for businesses, governments and consumers alike - would be through centralising the administration of the proposal, for example through implementing a One Stop Shop with the following features;

- Multinationals file a full tax return in their parent company location, no filing obligations would occur in the local jurisdiction, nor would there be any requirement to have fiscal representation.
- Allowing payments to be reallocated to be paid to, and distributed by, the tax authorities in the jurisdiction of the parent company of the group (the alternative is having to directly make cash payments to new jurisdictions, which could have several Treasury issues).

Additional coordinated work with the Forum on Tax Administration could explore technological solutions and simplified administrative practices to assist the implementation of such an approach.

ii) **Clarity over the nature of this profit allocation from a legal/other tax perspective:** Where additional profit is attributed to market jurisdictions and/or a new corporate tax nexus is created clarity is needed over the following areas otherwise the proposal could result in changes in business behaviour which may hamper growth, investment and cross-border trade;

- That a deemed nexus for the purposes of this proposal does not give rise to other tax or legal implications.
- That any new nexus, or deemed nexus principles, and profit allocation are only applicable for direct tax purposes and will not give rise to additional filing or tax requirements for other taxes.
- No exit taxes are to be levied in transition to the new system by jurisdictions.

3) Calculation of group profits for Amount A.

Step 2) Identify or derive the relevant consolidated accounts profit figure or component which is to be used as the starting point for the Amount A allocation (we say 'or derive' as it is not clear that accounts segmentation boundaries will generally match the intended tax ones).

3a) What would be an appropriate metric for group profit?

For the proposal to pass public scrutiny, how group profit is derived for these purposes must be transparent and simple to follow. We would therefore propose that profit from the audited consolidated financial statements would be the most appropriate metric for group profit.

The majority of our members consider that transparency would be best achieved through minimal tax adjustments and therefore profit before tax is used as the starting point for the calculation of Amount A. In practise, the key driver for many tax adjustments is a response to base eroding and profit shifting activities, which when viewing a business at a consolidated level should not be in point.

However further consideration is needed over the treatment of exceptional items in the income statement which are not reflective of performance for the year and distort margins (such as impairments, fair value movements, capital gains/losses on disposals). Consideration is also required of those exceptional circumstances where accounting treatment at a consolidated level could lead to large discrepancies in treatment over arrangements that are similar in nature. For example, consolidated accounts seek to eliminate difference between M&A undertaken as an asset deal and that undertaken as a share deal. Thus, a set of very similar consolidated accounts could have a combination of very different individual statutory accounts within it and different taxable profits and cash tax obligations as a consequence.

3b) What, if any, standardized adjustments would need to be made to adjust for different accounting standards?

Whilst we consider that adjustments should be minimal as noted above, where differences in accounting standards lead to a material difference over accounting presentation (and therefore group profit) for arrangements that are to all extent and purposed identical, further consideration is required as to whether standardised adjustments are required.

3c) How can an approach to calculating group profits on the basis of operating segments based on business line best be designed? Should regional profitability also be considered?

Segmentation by business line/regions has the benefit of reflecting variations in profitability between different markets (and ensuring that highly profitable jurisdictions are not subsidising markets which are loss making or making very low margins). However, this has to be recognised in the context that such segmentation has the potential to add significant complexity where data is not readily available and therefore a pragmatic approach is essential. Any proposals should leverage data already collected by the business.

To achieve this we are in favor of a presumption of the taxpayer's segmentation however, this must come with a prohibition against governments asserting their own segmentation to enhance returns to their jurisdiction. Businesses have an obligation to investors to report segments that are meaningful to their business and this should be respected for the purposes of this proposal - each group has a different structure and builds up their management data in different ways. Taxpayers should have the option of using consolidated worldwide profits, which is the starting point for the Secretariat's proposal for the Amount A profit allocation.

One practical way of administering this would be for business segmentation (or lack thereof) to be agreed upfront with the home jurisdiction tax authority (through the concept of a One Stop Shop). If at a later date, the business amends its reporting segmentation then a further discussion would be required. It is essential that one country is responsible for agreeing these segments and the allocation of income and costs to them, in the absence of this a myriad of models will arise likely leading to material instances of double taxation.

Further consideration of the following is also required;

- Many businesses will have a mixture of domestic and international business, so there will be some profit that should be reallocated and some that shouldn't – further consideration is needed over how home-country carve outs are dealt with. Not all businesses will have a business line approach that reflects domestic and international business separately.
- Not all business lines will reflect who the business sells its products to (i.e. consumer-facing versus business/government sales). For many businesses where there are sales to both businesses/governments and consumers, specific tracking is unlikely to be possible.
- Composite businesses (i.e. where there is an in-scope core element but various business models some of which add an element which would be out of scope if conducted separately).

4) Determination of Amount A

In our view the determination and allocation of Amount A will include a number of steps which we have outlined below;

Step 3) Allocate that profit (using whatever mechanics are determined) between a routine profit amount and a non-routine profit amount.

As outlined in Section 3c , segmentation has the potential to add significant complexity. If the solution only applies to certain business models or segments, this would force companies to prepare bespoke, segmented financials, which would lead to complexity, uncertainty and disputes amongst tax authorities. The complexity of preparing these financials for taxpayers should not be underestimated, and it does not appear proportionate in this case.

To minimise such complexity and limit the need to segmentation to targeted cases, Amount A should not apply to a share of all residual returns, but rather focus the application of the Unified Approach to

MNEs earning “significant profits” (i.e. well above average) for whom historic transfer pricing allocates no or low taxable profit to their market countries. For example, “significant profits” could be based on an average group margin (say above a fixed agreed percentage) to capture the excess return of greatest concern, whilst limiting the impact (and compliance burden) on businesses more broadly.

In excluding deemed routine profit to identify deemed residual profits, it will also be important that the following challenges are recognised and built into any allocation mechanism;

- Recognition that the routine component of profits may vary significantly between business models and that associated segmentation issues will arise.
- Low margin returns in some jurisdictions are driven by other taxes (duties/indirect taxes) which make up a high proportion of the price. This needs to be factored into the allocation of Amount A otherwise those countries that impose higher indirect taxes could be entitled to an even greater allocation of taxing rights.
- That the regime ensures that Amount A is only allocated once all functions have been rewarded cumulatively on a routine basis (one way to achieve this may be through multi-year averaging)– this is especially relevant for R&D intensive businesses where R&D is incurred and expensed many years before commercial sales and profits, giving the illusion of returns in excess of a routine amount. There can often be a temporal dislocation of many years (10+ in some cases) between R&D spend and associated revenues.
- Existing transfer pricing methodologies under the arm’s length principle (ALP) often result in an element of non-routine profit being allocated to the market jurisdiction already. It is therefore important that there is no double counting with any Amount A allocation.
- Specifically, to the extent Amount C represents currently allocated profits under ALP transfer pricing, care must be taken to ensure Amount A does not double count non-routine profit already included in Amount C, e.g. for a full function, risk-bearing in-market affiliate.

Step 4) Allocate the designated proportion of that non-routine profit amount between the markets served by the relevant entrepreneur in accordance with whatever are the allocation principles determined.

Before Step 4 takes place, it is essential that this is done in collaboration with Steps 5 – 7 below. Proceeding with Step 4 ahead of Steps 5 – 7 being agreed will likely lead to an increased risk of double taxation and further uncertainty over tax positions for both governments and businesses alike.

Before market jurisdictions are allocated a portion of non-routine profit, it is essential that the country in which the residual profits arise under existing rules must also sign up to Pillar 1 and centralised dispute resolution mechanisms (including mandatory binding arbitration). Furthermore, it is important that the corresponding reduction in income in the surrendering country must be agreed at the same time as any profit is allocated under Amount A - one sided adjustments should not be permitted.

Step 9) Make any necessary filings/payments in the market jurisdictions when required.

Please refer to our comments in respect of Section 2 and the importance of minimising the administrative burden arising from the creation of a new nexus and the need for centralised administrative process (for example a One Stop Shop).

It is essential that all other steps take place and are agreed with the respective tax authorities before filings/payments in the market jurisdiction take place (whether directly or via intra-tax authority means under a One Stop Shop). In the absence of such an agreement ahead of this step, there will be an increased risk of double taxation.

5) Elimination of double taxation in relation to Amount A.

5a) Identifying relevant taxpayer(s) entitled to relief.

Step 5) Analyse and determine which legal entities are, or may be, relevant entrepreneur entities with an amount to surrender some proportion of the Amount A non-routine profit which is to be re-allocated from resident jurisdictions to market jurisdictions.

The consultation document focuses on which jurisdictions the allocable residual profit (Amount A) should be allocated to however, further thought is needed on which jurisdiction or jurisdictions and entities surrender the Amount A, with the proposal clearly identifying the surrender state or states.

The residual profit for many multinational enterprises is likely to arise in more than one jurisdiction (for example where they hold their IP in more than one location). Determining where residual profit is allocated from will be essential in avoiding double taxation.

Where countries disagree on the calculations and allocation of Amount A, or which entity it should be surrendered from double taxation will likely arise. Further consideration is therefore required as to a standard method set for allocating between entrepreneurs and associated arbitration, overseen by a centralised process.

A particular risk area will be where businesses operate a full risk distributor model as there will be no obvious principal company from which profits can be allocated from. Unless an exception applies to full risk models, a standard method for determining the surrendering entity will be required otherwise there could be a reluctance to surrender profits from "distributors" resulting in double taxation.

Step 6) Attribute or allocate the non-routine profit amount calculated under Step 3) between the relevant entrepreneur entities identified in Step 5.

A process is required to agree which entrepreneur entity the Amount A has been reallocated from, as there may be multiple entities in several different countries from which profits could be allocated. It is unlikely that a bilateral transfer could be identified. Given the multilateral nature of the reallocation of Amount A, further thought is required over how this reallocation will be managed and highlights the need to centralise the process through a One Stop Shop.

5b) Building on existing mechanisms of double tax relief, such as tax base corrections, tax exemptions or tax credits.

Step 7) Make any necessary adjustments to the tax returns of the resident entrepreneurs to exclude taxable profits which are to be allocated to market jurisdictions.

Initial allocations to surrendering entrepreneurs will need to be adjusted out from their existing local taxable profit figures which may reflect different GAAP and local tax adjustments. For example, if Amount A is taken from consolidated accounts, the surrendering entrepreneur entity may have no taxable profits (for example if they have accelerated depreciation). Further consideration of such situations is required to prevent double taxation – allocation of amounts to market jurisdictions should not be made unless an equal adjustment can be made in the resident entrepreneur entity.

Step 8) ***Make any other necessary adjustments or claims to eliminate double taxation (e.g. withholding tax refunds if reallocated profits have already been taxed in the market jurisdiction via withholding taxes).***

Where new allocation principles would overlap with existing allocations of taxing rights via withholding taxes (e.g. on interest, royalties and technical services fees) then they must substitute withholding taxes deducted at source to prevent double taxation.

If royalty income is treated as group residual profit, which may be allocated differently under Amount A, there will be a significant problem obtaining double tax relief for royalty withholding taxes.

6) Amount B

6a) The need for a clear definition of the activities that qualify for the fixed return.

If Amount B is to achieve the objective of providing business and governments alike with greater certainty over their tax position, it will be necessary to define both those activities that are routine activities for the purpose of the Amount B and just as importantly those that are not brought into account.

6b) A determination of the quantum of the return (e.g. single fixed percentage; a fixed percentage that varied by industry and/or region; or some other agreed method).

The majority of members support a fixed percentage based on industry considerations, with some members noting that a global fixed percentage on an industry basis along the lines of the ATO guidance would be preferred for administrative ease[1].

However, agreeing the fixed percentage for Amount B for all situations will be extremely complex, and consideration is required to ensure that the percentage used is not so high as to create distortions.

An alternative would be for Amount B to be an elective safe harbour rather than a fixed percentage. Taxpayers should be entitled to choose whether to use the safe harbour based on their own facts and circumstances, recognising these will be different for all taxpayers. This should be unpinned by clear guidance on how the safe harbour should be applied and the nature of the activities that are in scope. In all cases, this should be underpinned by robust dispute resolution procedures.

Further consideration should be given to the following;

- The application of a fixed return to loss making or low margin businesses with a potential for a cap to be placed on any fixed return to not create (further) losses.
- That Amount B should not represent a fixed minimum remuneration that tax authorities seek to achieve further returns above this amount – this would only lead to additional disputes.
- There should be a clear and unambiguous definition of the activities that fall within the scope of Amount B, including consideration of the treatment of entities that may perform mixed activities including both in-scope and out-of-scope activities.

[1] It is worth noting that the “amber” range in the ATO guidance should be considered the interquartile range. What is “green” for the ATO under this guidance would be “red” for the tax authority at the other end of the transaction thus pointing towards the amber zone as appropriate.

- Risk bearing distributors should by nature have already earnt Amount B in the right location and therefore we question whether applying the proposal to all distributors only adds unnecessary complexity - further analysis is required on what different levels of risk profiles are and how the proposal can be focused on low risk distributors.

7) Amount C/dispute prevention and resolution.

The CBI recognises the political desire to make progress on the question of how to reflect the increasing digitalisation of the global economy in the tax system. Members support action to address these concerns.

However, it is of fundamental importance for all our members that an international consensus must be reached which ensures that firms are subject to taxes which equate to only taxing their profits, not revenues, once. For every £1 of profit that is allocated to a market country, there must be an equal and opposite adjustment by another country to relinquish taxing rights over the same profits. This is critical to ensuring there is not double (or multiple layer) taxation.

In our view this can only be achieved through the following;

1) **Clear interaction between Amounts A, B and C**

   Further consideration is required between the interaction of Amounts A, B and C to avoid double taxation occurring.

   Further guidance on how Amount B will interact with Amount C is required. For example, there may be additional functions performed in marketing jurisdictions that are closely linked to the baseline marketing and distribution functions i.e. local manufacturing. The additional functionality may result in tax disputes over whether it relates to baseline activities and/or the level of additional profit that should be earnt on an arm's length basis under traditional transfer pricing methods.

   As well as additional functionality which Amount C focuses on, there is a lack of clarity over the treatment where there is less functionality than assumed within the concept of baseline marketing and distribution functions. This gives rise to the concern that by using a simplifying convention (such as a fixed percentage formula for Amount B), this may result in a calculated amount that is higher than based on the actual activity in a market jurisdiction. Dispute prevention and resolution under Amount C should not just be used for increased functionality but also reduced functionality. Alternatively, further consideration should be given to whether Amount B should be a safe harbour, as we have outlined in Section 6b above.

   Further consideration is required where there is already an existing presence in the market to determine how Amount A interacts with Amounts B and C. To this regard the following should be considered;

   - Guidance is required to understand how an outcome under Amount C will impact the allocation of profit to market jurisdiction under Amount A in order to avoid double taxation.

   - Where a business is already in a country and compensating the country via Amount B and Amount C, at or in excess of the Amount A, no additional return should be allocated to the market (i.e. Amount A should be the guaranteed minimum that a country can expect for sales into the country).

- The risk that Amounts B and C together effectively result in the current arms' length regime (with a floor) and all current issues and risks of dispute remain. These are then added to by new dispute risks associated with Amount A and the risk that the aggregate of A, B and C over rewards the markets when countries push hard for Amount C.

2) **Introducing a new required minimum standard for dispute resolution**

The importance of effective dispute prevention and resolution mechanisms cannot be underestimated. The proposal being considered is anticipated to result in changes in relative country taxing rights – which may significantly change countries' relative fiscal positions - with this comes the increased risk of disputes arising. It is therefore essential that alongside any new rules must sit effective prevention and dispute resolution mechanisms, which will be essential in eliminating instances of double (or multiple layer) taxation and providing taxpayers with certainty.

We consider this an opportunity to rethink how international dispute resolution can be reformed to avoid double taxation so as to remove the risk of a potential disruption of international trade – via introducing a new required minimum standard to be adopted for dispute resolution.

This needs to build on three key processes;

i) ***Mandatory binding arbitration*** (MBA) to be ***adopted on a multilateral basis with peer review* –** Arising from the multilateral nature of the proposal comes the increased likelihood of disputes spanning multiple jurisdictions – rendering traditional bi-lateral dispute resolution mechanisms ineffective.

ii) ***Centralised process* –** The increased likelihood of multilateral disputes highlights the need for further centralisation of dispute resolution mechanisms otherwise the system will quickly become unworkable. A One Stop Shop, with a centralised audit process could achieve this objective. Though we recognise this would need to be met with appropriate safeguards (for example peer review) and transparency over the calculation of tax liability to enable countries to maintain their sovereign right to challenge the tax calculation (albeit through intra-tax authority discussions).

    However, overall we consider this would bring benefits, particularly for tax authorities in smaller/developing market jurisdictions, as they could rely on the infrastructure of the One Stop Shop jurisdiction to do the work (which they can potentially review) but wouldn't have to set up new infrastructure of their own to try to administer the collection/audit of tax returns/liabilities from non-resident multinationals.

iii) ***Certainty for taxpayers*** including MBA as mentioned above and a clear time limits in which disputes can be raised.

    Further work is required to understand the interaction with current dispute resolution and arrangements such as APAs and MAP with many taxpayers noting the benefits of these in providing certainty, whilst recognising that these proposals need to go beyond this.

3) **Commitment to cohesive international tax framework**

An important part of dispute prevention will also be the commitment by countries to repeal (and not introduce new) unilateral measures which seek to increase their tax base (such as Digital Services Taxes, Diverted Profits Taxes and profit fragmentation rules etc) and lead to increased risks of double taxation.