

# OECD released Pillar One draft Model Rules on revenue sourcing and nexus of Amount A

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Issue 2

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## In brief

On 4 February 2022, the Organisation for Economic Co-operation and Development (OECD) released the draft Model Rules on the nexus and revenue sourcing of Amount A under Pillar One of Base Erosion and Profit Shifting (BEPS) 2.0<sup>1</sup> for public consultation (with comments due on 18 February 2022). This is the first in a series of rules that the OECD is expected to release for public consultation over the coming months.

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## In detail

### Background

Pillar One will apply to multinational enterprises (MNEs) with profitability above 10% and global turnover above EUR 20 billion. Under Pillar One, a formulaic share of the consolidated profit of in-scope MNEs (Amount A) will be reallocated to market jurisdictions where sales arise. The profit to be reallocated to market jurisdictions will be calculated as 25% of the profit before tax in excess of 10% of revenue.

The Model Rules on Amount A will provide a template for jurisdictions to give effect to the new taxing right in their domestic legislation. The OECD will launch a public consultation on the draft Model Rules in stages, and the first set of draft Model Rules released by the OECD covers the nexus and revenue sourcing of Amount A. After receiving input from stakeholders, the draft Model Rules will be revised and translated into the Multilateral Convention (MLC) and an accompanying Explanatory Statement for approval by the OECD/G20 Inclusive Framework on BEPS (IF). The goal is for the MLC to be open for signature by mid-2022.

### Nexus

The special-purpose nexus rule will apply solely to determine whether a jurisdiction qualifies for profit reallocation under Amount A and will not alter the nexus for other tax or non-tax purposes (i.e. the nexus rule is designed as a standalone provision to limit any unintended spill-over effects). To determine whether a 'Covered Group' (i.e. an MNE in-scope of Amount A) satisfies the nexus test for Amount A in a jurisdiction, the revenue sourcing rules will be applied to identify the jurisdictions in which revenue arises for the purpose of Amount A. The nexus threshold will be (i) EUR 1 million for jurisdictions with annual GDP equal to or greater than EUR 40 billion and (ii) EUR 250,000 for jurisdictions with annual GDP less than EUR 40 billion. The MLC will outline an agreed approach to currency fluctuations.

## Revenue Sourcing

The revenue sourcing rules will provide a methodology for a Covered Group to use available information to reliably identify the market jurisdiction based on a range of possible indicators, or, in cases where a 'back-stop' is needed, based on an allocation key that is expected to provide a reasonable approximation of the market jurisdiction. The use of 'back-stop' allocation keys recognises that it could be challenging and sometimes impossible for a Covered Group to source revenue to the defined market jurisdiction in certain circumstances (particularly for third-party distribution arrangements, components, certain services and intangible property). The 'back-stop' rule will also ensure that no revenue goes unsourced.

The revenue sourcing rules will be structured as a general legislative article that articulates the sourcing approach, supported by a schedule setting out the detailed sourcing rules for seven revenue categories<sup>2</sup>, namely (i) finished goods, (ii) components, (iii) services, (iv) intangible property, (v) real property, (vi) government grants and (vii) non-customer revenues. The legislative article and schedule are intended to be binding.

A Covered Group must source all revenue using a 'reliable method' (i.e. using a 'reliable indicator' or an allocation key as defined in the detailed sourcing rules) based on the Covered Group's specific facts and circumstances. The primary rule is that revenue must be sourced on a transaction-by-transaction basis according to the category of revenue earned from the transaction. A 'transaction' refers to the item that generates income (e.g. the individual item of inventory or the 'clicks' on an online advertisement) and does not mean the invoice. If there are different items or services contained on one invoice or contract and goods or services are sold in different jurisdictions, the revenue allocation must be in proportion to the revenue earned in each market (rather than an equal split). Moreover, if a contract specifies different prices for different locations, these pricing differences must be considered. Furthermore, transactions comprising different elements that fall under more than one revenue category should be sourced according to their predominant character. It is expected that further guidance on the transaction-by-transaction approach will be provided in the Commentary to be issued.

## Documentation requirements

A Covered Group is required to document its approach to revenue sourcing at a systemic level instead of at an individual transaction level. This means a Covered Group should maintain a clear and intelligent internal control framework demonstrating its conceptual approach to revenue sourcing, how it obtains the necessary data and how it monitors the data accuracy via internal checks. These requirements will be elaborated in the standardised documentation requirements in the final Model Rules.

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## The takeaway

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While the public consultation document provides that the draft Model Rules have been designed to balance the need for accuracy with the need to limit compliance costs, the rules are complex and pose challenges to tax administrations and businesses in terms of implementation and compliance.

Although affected MNEs are required to document their approach to revenue sourcing at a systemic level instead of at an individual transaction level for compliance purposes, businesses will still need to make system adaptations to track every transaction line by line on their invoices (and capture price differences in different markets), which could be a massive undertaking. To minimise the compliance burden, a preclearance of data collecting techniques of these MNEs including their regional headquarters and relevant local subsidiaries would be appropriate as this could provide some level of certainty to businesses before rebuilding their systems.

There are issues that may require further clarification in the final Model Rules. For example, the relationship between the revenue sourcing rules of Amount A and the sourcing rules under the domestic law and/or tax treaties is not entirely clear under the draft Model Rules. In addition, the transaction-by-transaction approach raises questions on how the 'predominant test' applies to embedded transactions where, for instance, goods and services are provided on a package basis instead of an itemised basis. In the event of (online) services being provided to a customer that is operational in different jurisdictions and that utilises these (online) services simultaneously in a range of jurisdictions, questions are raised as to how the revenues earned from these services should be sourced to individual markets under the envisaged sourcing rules.

The draft Model Rules on the nexus and revenue sourcing of Amount A are the first in a series of rules that the OECD is expected to release over the coming months. The draft Model Rules are released as working documents for public consultation purposes and do not reflect the final views of the IF members. Affected MNEs should keep a close eye on further details coming up, including the draft Model Rules on other aspects of Pillar One, the final Model Rules and the explanatory Commentary. They should also consider providing comments and feedback on the draft Model Rules for the OECD's consideration.

Both the Mainland China and Hong Kong SAR governments have expressed commitment to G20/OECD's Two Pillar Proposal.

In a recent virtual meeting with Pascal Saint-Amans, Director of the OECD Centre for Tax Policy and Administration, Wang Jun, Commissioner of the State Taxation Administration of China, stated that the proposal will help address the challenges of the digital economy. Meanwhile, the Advisory Panel on BEPS 2.0 set up by the Hong Kong SAR government has recommended, among other things, that Hong Kong should implement Pillar One by adhering to the tax framework endorsed by the international community and by participating in the new MLC, as this would help affected businesses eliminate double taxation and reduce compliance costs. As the draft Model Rules become available in stages, we look forward to more details being released by the governments soon.

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## Endnotes

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1. The draft Model Rules on the nexus and revenue sourcing of Amount A can be accessed via this link:  
<https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-nexus-revenue-sourcing.pdf>
2. For an overview of the revenue sourcing rules by revenue category, please refer to the *PwC Global Tax Policy Alert, 8 February 2022*, which can be accessed via this link:  
<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-launches-public-consultation-on-p1-draft-model-rules.pdf>

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## Let's talk

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For a deeper discussion of how this impacts your business, please contact:

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