ITI Response to Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing

18 February 2022

Tax Treaties, Transfer Pricing, and Financial Transactions Division (OECD/CTPA):

Thank you for the opportunity to provide feedback on the Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing.

The Information Technology Industry Council (ITI) is the premier global advocate for technology, representing the world’s most innovative companies. Founded in 1916, ITI is an international trade association with a team of professionals on four continents. We promote public policies and industry standards that advance competition and innovation worldwide. Our diverse membership and expert staff provide policymakers the broadest perspective and thought leadership from technology, hardware, software, services, and related industries.

Our members have consistently supported the negotiations at the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework (OECD/IF), including through regular technical engagement and the May 2020 publication of Principles for a Solution in the OECD’s Project for Addressing the Tax Challenges of the Digitalisation of the Economy. Global tax policy challenges require global tax policy solutions, which is why more than 140 governments and more than a dozen observer organisations have committed to the negotiations taking place under the auspices of the IF. We appreciate the opportunity to provide feedback on the draft Model Rules and intend to continue engagement with the OECD and the IF as development of model rules, legal instruments, and other elements of the Two-Pillar Solution continues.

Overall, ITI has serious concerns with the complexity and administrability of the draft Model Rules. Of particular concern is the broad reliance on transaction-by-transaction sourcing and the approaches to sourcing revenues from advertisement services, components, business-to-consumer (B2C) services, and business-to-business (B2B) services. We have presented recommendations for simplifying these approaches, as well as several points to guide the OECD/IF’s revision and completion of the Model Rules and Commentary.

General Articles

The draft Model Rules include several references to guidance that will be developed further in the Commentary. While we have identified challenges based on the draft Model Rules, we recognize the administrability of the Model Rules will rely in large part on the details, examples, and guidance to be articulated in the Commentary. We look forward to providing feedback to Commentary and the Multilateral Convention (MLC) and its Explanatory Statement.

Revenue sourcing rules for Amount A must be sustainable, clear, predictable, provide tax certainty, and not create excessive compliance costs through information gathering that is not otherwise done for a business purpose. The proposed sourcing rules (including the “detailed record-keeping” requirement and demonstrating proof of “internal checks to monitor the accuracy” of data used) are
very complex and burdensome, and are likely to cause tax disputes and lead to double taxation. For companies already struggling to stay compliant with rapidly changing tax reporting requirements around the world, layering on additional reporting requirements will lead to additional costs that will hamper companies’ ability to remain competitive in the global marketplace.

The Background states that jurisdictions “could use [the Model Rules] as the basis” and “will be free to adapt these Model Rules.” The structure as described raises the possibility that the implementation of Pillar One becomes a patchwork of rules. This is especially an issue for nexus and revenue sourcing as conflicting rules in different jurisdictions will lead to double taxation. The potential for discrepancies and the overall complexity underscore the strong need for an early certainty process and mandatory binding dispute prevention and resolution mechanisms for all participating jurisdictions to ensure there will be effective resolution of definitional questions and determinations about reliability of data sources.

It is also critical that the final documents disincentivize governments from seeking additional taxing rights through aggressive audits related to Pillar One. While global tax challenges require global tax solutions, governments have several motivations for engaging with the IF, including providing certainty and predictability for taxpayers and tax administrations. The assertion of further tax claims based on information submitted as part of complying with Pillar One would detract from the spirit in which these negotiations were conducted, and undermine the certainty sought by reaching a final agreement. The introductory statement already makes clear that the new special purpose nexus is exclusively used for Amount A. We would encourage the OECD/IF to make clear in the Model Rules, Commentary and/or Explanatory Statement that audits related to Pillar One should not be used to as a basis for additional tax claims.

**Source rules**

While we provide specific feedback below, we thought it would be useful to outline key principles based on the stated objective to design “revenue sourcing rules [that] balance the need for accuracy with the need to limit compliance costs.”

Companies should be able to use data that they acquire in the ordinary course of business, and they should not be required to request information from third parties. Examples of relevant data that may already be held by companies include the impression location for ads and warranty registration data for B2B sales described above. In that regard, wherever a list of indicators is provided, a company should always be permitted to use a mix of those indicators to account for the different location data that may be available in the ordinary course of business, which inevitably evolve over time in response to industry and regulatory changes. Creating new data requirements in order to comply would significantly increase complexity and potentially risk conflicting with privacy rules, such as the European Union’s General Data Protection Regulation (GDPR).

Companies should not be required to build out expensive, time-consuming systems and processes without other business value simply to source transactions for purposes of Amount A. In that regard, the “Knock-out Rule” is unrealistic and unduly burdensome. Rules should not require taxpayers to prove a negative. Further, no taxpayer at the scale of Amount A companies will be able to do a contractual analysis by customer to determine if this applies. To the extent that this feature is kept, it should be solely elective for taxpayers who wish to do this for selected transactions.

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1 “Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing” at 3.
Requiring companies to review contractual data for transactions or customers is unreasonable. This information typically is not organized and stored in systems and contractual language will often not contain the relevant location data. For example, a contract with an independent distributor may provide that the distributor can sell finished goods within Asia, as opposed to a specific country within the region. The issue is magnified because companies at this scale would have millions of customer contracts, and it is not scalable. Requiring companies to review contractual data in this way should never be required, even if in some cases it is permitted so that taxpayers can affirmatively show reliability in certain cases.

Schedule A – Detailed Revenue Sourcing Rules

Given the brief nature of the consultation, we have focused this comment on a few discrete sections. In addition to revisions based on feedback received through this consultation, there will likely be cause to further iterate and refine the revenue sourcing rules once the parameters around excluded industries are finalized. We encourage the OECD/IF to continue to engage the business community as interdependent elements of the project come into greater focus.

Part 1 – Categorising transactions

Leading with a transaction-by-transaction approach is fundamentally unworkable. ITI’s member companies are undertaking millions of transactions every day. We would strongly encourage taking a systems-approach or an approach that incorporates statistical sampling or aggregate market data to better balance accuracy with compliance costs.

While the public consultation document previews the inclusion of further details in the Commentary, we would like to emphasize our interest in greater clarity around the determination of a transaction’s “ordinary or predominant character.” There are certain online purchases (e.g., an in-app purchase in an online game) that do not neatly fall into one category. As an example, an in-app purchase in an online game could be categorised as Digital Goods or B2C services.

For taxpayers with a predominant business line and a de minimis secondary revenue stream, the costs to track, source and allocate the de minimis revenue stream (and for tax authorities to audit it) far outweigh the benefit in incremental sourcing/allocation accuracy. A de minimis rule should be added such that taxpayers in this example may source the revenues of the de minimis revenue stream in the same proportion as the revenues of their primary business line. This would provide efficiency gains for all involved, and no revenue would remain unsourced/unallocated.

Footnotes 14 and 30 preview that the Commentary will provide further guidance on government procurement. We would request that the Commentary clarify and confirm that sales or services to the government are sourced to the jurisdiction of the agency.

Part 2 – Reliable Method

We appreciate that the Reliable Method as drafted assigns equal weight across all suggested indicators so that MNEs can make use of the information they have already collected for commercial purposes. This approach will lessen the burden on companies to prove why an indicator is unreliable, and it acknowledges that companies have different methods to track the source of revenue to a market jurisdiction. However, we reiterate again that companies should be able to use data that they acquire in the ordinary course of business and that companies should not have to acquire new data...
solely for the purpose of sourcing transactions for Amount A. Companies should not be required to rely on information collected by, and passed to them by, another taxpayer (such as a customer) in order to determine sourcing. This is particularly important in situations where another taxpayer that has the consumer information is a financial institution or an extractives industry business that would be exempted from Pillar One. Further, the rules should clarify that companies should be able to rely on any Reliable Indicator without the need to demonstrate that such an indicator is the “best” indicator.

Part 3 – Finished Goods
“Tail-End Revenue” addresses cases where a taxpayer is unable to gather reliable data about the last 5% of revenues for a transaction. While this is helpful, it does not address the fundamental issue that systems for compliance (in the best of cases) will be expensive and require significant resources. Companies at the scale that are in-scope for Amount A cannot develop systems for every single product in existence without extremely disproportionate costs. These companies should be able to use billing addresses for amounts that represent 10% or less of the company’s total revenues from third parties, without first having to consider alternative methodologies of establishing a relevant location.

Moreover, in the ordinary course of business, these companies may record certain adjustments to revenue (e.g., certain contra revenue transactions) with respect to no specific customers. Additionally, companies should be permitted to prorate adjustments to revenue that are not recorded with respect to specific customers using a reasonable methodology such as by revenue or product, depending on how these adjustments are recorded in the ordinary course of business.

Part 4(A) – Revenues from Components
Requiring component manufacturers to determine revenues based on the final customer of the final finished good establishes an impossible standard with which component manufacturers cannot be reasonably expected to comply. The OECD previously acknowledged this challenge in January 2020 when, in the context of the previous scoping of Amount A, it excluded from scope “businesses selling intermediate products and components that are incorporated into a finished product sold to consumers.”2 For example, components like semiconductors are sold in bulk and incorporated and substantially transformed by unrelated parties into altogether different products (e.g., a mobile phone, a computer, etc.) or sold in bulk to a third party. While there may be a contractual relationship between the component manufacturer and the component distributor or the Finished Good manufacturer, there is no contractual relationship with or visibility into the multiple tiers of Finished Goods distributors, resellers, or retailers down channel. As such, the taxpayer that manufactured the Component does not know the location of the Final Customer of the third party’s Finished Good.

The proposed sourcing rules for revenues from components need to be revised to a standard that companies can reasonably and practically meet. We would recommend that for components, the “revenues derived from a transaction for the sale of Components are deemed to arise in [a Jurisdiction] when the Component is sold to the direct customer of the Component manufacturer.” Building from the Model Rules’ default position of sourcing on a transaction-on-transaction basis, the “sold to” information is the most reliable and reasonable indicator that the component manufacturer

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collects pursuant to its commercial and legal obligations. At a minimum, the “revenues derived from a transaction for the sale of Components are deemed to arise in [a Jurisdiction] when the Component is the place of delivery to the direct customer of the Component manufacturer into which the Component is incorporated in [a Jurisdiction].” While the “sold to” information is the most verifiable information the component manufacturer receives from a third party with respect to the use of its product, at a minimum, the component manufacturer should only be responsible for having information about the third party from which it directly derives revenues.

Part 5(B) – Revenues from advertising services
We have concerns about the proposed approach to source revenues from advertising services on a transaction-by-transaction basis, which requires a sub-invoice analysis. The most detailed level of analysis should be at the customer level by legal entity. For this purpose, a customer should be a customer as defined in a company’s billing system.

Different businesses track interactions with users in different ways (e.g., impressions, clicks, acquisitions, etc.). As long as taxpayers are using a reasonable data-driven location indicator, there should be flexibility in which approach taxpayers take, based on what is most reasonable given their systems limitations and data already readily available in the ordinary course of business. Because the availability of location data may vary across products or customers and change over time in response to regulatory or industry practices, companies should be permitted to use the location data that is available in the ordinary course of business (e.g., device location, IP address location, location based on a combination of indicators/multi-factor, etc.). To avoid the duplication of compliance requirements, limit unnecessary costs, and reduce needless disputes, there should be a safe harbor for any methodology that establishes impression location in a similar manner required for any other tax compliance purpose.

There are likely to be multiple applicable Reliable Indicators for sourcing online advertisements, some of which may conflict based on the nature of the information obtained. The Model Rules should clarify that where there are multiple Reliable Indicators, the taxpayer has the option to choose among them.

In the example for online advertising, the footnote alternates between referring to viewers and users as a way to source revenue. Even when online advertising revenue is not directly tied to the number of views or clicks, revenue from online advertising services should be sourced by reference to the viewers of ads, not a taxpayer’s users or “DAU” by jurisdiction, which do not accurately reflect the revenue from an ad. Additionally, guidance would be helpful regarding the fact pattern where an ad buyer pays a single price globally for unlimited views during a specified time, which should follow the same sourcing rule of viewers per jurisdiction.

Part 5(G) and Part 5(H) – Revenues from business to consumer services and revenues from business to business services
The comments below are applicable to the draft approaches to sourcing revenues from B2C services and those from B2B services. As an overarching comment, we recommend that the Model Rules for sourcing revenues allow companies the option to rely on Value Added Tax (VAT) indicators to improve the administrability of the rules and to benefit from tapping into existing, well-functioning systems familiar to taxpayers and tax administrations alike. We have also provided feedback on the currently proposed design elements.
First, it is overly complicated for companies to distinguish between Consumers, non-Large Business Customers, and Large Business Customers, particularly because it may not be possible to discern whether a customer acquires a good or service for personal purposes rather than commercial or professional purposes. In some instances, the same customer may acquire goods and services for personal and commercial or professional purposes. Covered groups may have thousands or millions of customers and may not have the ability to discern the country-by-country reporting obligations of customers (public financial data may not exist or be readily available to a Covered Group). Further, linking contracting parties to their company may not even be possible (i.e., an affiliate in a jurisdiction may operate under a name unrelated to that of its parent). There should be greater clarity in the Model Rules about the circumstances under which a company would be expected to identify a link for a contracting company, as this may prove exceptionally challenging for non-Large Business Customers.

Second, soliciting the headcount of customers, and any other metric that requires customers to provide business their non-public business data, is inappropriate. Customer headcount information is not commercial and does not answer the question of where services are used better than more commercial information, such as VAT indicators. The contracting employee of the business customer may not have access to the relevant information or may have valid business reasons for not wanting to share this type of information with the covered group. Customers may not be willing to share their non-public business data because it is burdensome on them and reveals confidential information to another company. It also makes taxpayer compliance dependent on third parties that are not under the control of the taxpayer. Accordingly, to the extent that documentation options require the use of third-party data (e.g., the Large Business Customer exception), these options should be elective because they are impractical and inappropriately interfere with third-party business relationships of the taxpayer.

As noted several times in this submission, ITI broadly urges that any rule be limited to information already collected in the ordinary course of business and which does not require additional information from customers. Both taxpayers and tax authorities benefit from the reduced complexity, disputes, and risk of double taxation. As such, it would be useful to allow Covered Groups the option to elect to use an allocation key, which can help to achieve a balance between accuracy and administrability. We would recommend that the Global Allocation Key be such an allocation key given that it has already been considered by the Task Force, although other allocation keys could potentially serve a similar purpose.

Specific to B2B cloud services, companies may have limited to no data available on the location where a customer uses B2B cloud services. Even if a company has data, the use of VPNs often makes that data unreliable. To determine whether a jurisdiction qualifies for profit reallocation under Amount A, the place of use should be based on the location of the first third-party customers. If this preferred option is not available, to the extent that taxpayers are required to establish the place of use for B2B cloud services, taxpayers should be permitted to do so using data to the extent that it is available in the ordinary course of business (e.g., location data on where a customer accesses certain cloud service interfaces to prevent fraud or abuse (interface data) or another internal source of location or usage data that could be associated with the provision of cloud services). As in the case of ads, the most detailed level of analysis should be at the customer level by legal entity, where a customer is a customer as defined in a company’s billing system (at the account level). There should also be a safe
harbor for any methodology that establishes access location in a similar manner required for any other tax compliance purpose.

Sales of tangible property to distributors (B2B sales) should be based on location data of final customers that companies obtain in the ordinary course of business, such as warranty registrations, electronic activations, etc. Companies may not be able to correlate this location data with revenue data because, for example, this data may not be consumed by billing systems in the ordinary course of business. In that case, companies should be able to use this location to compute an overall allocation ratio that can be applied with respect to all B2B sales at the company level instead of the customer level.

Finally, while geolocation data is sometimes available for B2C transactions, many companies do not collect this data on their customers and do not have any business reason to collect such data. Customers can also refuse to allow location data to be collected, making it unreliable.

**Part 10 – Definitions**

**Jurisdiction:** The Model Rules define jurisdiction as “a country or territory that is a jurisdiction for tax purposes.” We suggest revising the definition so that it includes only jurisdictions at the national level.

**Knock-out Rule:** The rule references a “reasonable assumption,” while the footnote seems to require “actual knowledge.” It should be clarified that the Knock-out Rule is based on reasonable assumptions and does not require actual knowledge. Second, the footnote suggests the knock-in rule may be used only with respect to headcount in that set of jurisdictions. It should be clarified that the knock-in rule may be applied before the application of any allocation key (e.g., including as applied to components and B2B services).

**Transition**

We wish to emphasize the importance of providing protections for taxpayers. For instance, there needs to be some means of providing early certainty before taxpayers subject to Amount A, design and build complex systems and processes to acquire and analyze the requisite data. One element of providing certainty to taxpayers is through the administration of a transition period with more flexible data allowed or allocation key provided, that is complemented by a process to obtain advance certainty on a taxpayer’s method prior to implementation of the system. A prohibition on the imposition of penalties should be prescribed as an element of the transition period.

We would also request that the OECD conduct a cost-benefit analysis or feasibility study to evaluate the functioning of existing requirements, prior to considering an expansion in the universe of companies in scope of Amount A.

**Conclusion**

Thank you again for the opportunity to provide feedback on the Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing. As stated in the introduction, our members are committed to the success of the work taking place under the auspices of the Inclusive Framework, and see a multilateral, consensus-based solution as the only sustainable outcome. We appreciate the Secretariat’s attention to our concerns and stand ready to answer any questions that may arise.