Pillar One aligns taxing rights more closely with local market engagement. If multinational consensus on this is not achieved, unilateral digital taxation measures may continue to proliferate.

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The Unified Approach

— Pillar One is a set of proposals to revisit tax allocation rules in a changed economy.

— The intention is that a portion of multinationals’ residual profit (likely to be generated by capital, risk management functions, and/or intellectual property) should be taxed in the jurisdiction where revenue is sourced.

— Applies to Automated Digital Services (ADS) businesses and Consumer-Facing Businesses (CFB). The scope is intended to be broad and covers businesses that are able to profit from significant and sustained interaction with customers and users in the market.

— Links taxing rights in respect of these businesses to their sources of revenue, which need not depend on physical presence in the jurisdiction.

Market engagement allocation

— “Amount A”: New taxing right allocates high value profits based on a formula, not necessarily the arm’s length position.

— Covers profits earned from activities with an automated digital (mainly online) character or goods/services commonly sold to consumers (as well as associated IP licences). Specific inclusions and exclusions are proposed.

— Amount A allocated based on local revenues (determined via sourcing rules) with double taxation elimination measures.

— “Amount B”: Standard arm’s length remuneration for “baseline” routine marketing and distribution activities.

— Alternative Amount B methodologies may be adopted if supported by evidence.

What businesses need to know

— These changes are multinational in scope and technically complex. The effects are likely to be far-reaching for many businesses, and the effects are not yet certain.

— Scope of covered businesses is not yet final, but it will not be limited to highly digitalised business models.

— Much of the detail remains to be agreed including scale thresholds, how the proposals are intended to apply to CFB, how the Nexus and revenue sourcing rules will operate, and the US proposal that departure from the arm’s length principle should be on a safe harbour basis.

— A period of open consultation on the proposals will now follow until 14 December 2020. The OECD has published its global impact analysis; potentially affected businesses should consider what these changes could mean for their ETRs.