KPMG

Memo

To Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA

From KPMG International

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Ref Comments on the Public Consultation Document for Pillar One – Tax certainty for issues related to Amount A

Professionals in the member firms of KPMG International[1] ("KPMG") welcome the opportunity to comment on the OECD's public consultation document entitled "Pillar One – Tax certainty for issues related to Amount A," released on 27 May 2022 (the "Consultation Draft"), as well as its companion public consultation document titled "Pillar One – A Tax Certainty Framework for Amount A," released on the same date (the "Amount A Draft"). This comment letter responds specifically to the Consultation Draft but should be understood in the context of our comments on the Amount A Draft, which have been submitted under separate cover.

The Inclusive Framework's October 8, 2021 "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" (the "October Statement") announced a historic commitment to tax certainty through mandatory and binding dispute prevention and dispute resolution for both the determination and allocation of Amount A and Related Issues associated with Amount A.[2]

We would like to start by welcoming the October Statement's commitment to the prevention of tax disputes and to providing tax certainty for taxpayers within the scope of Amount A. At present, the lack of wide-scale dispute prevention and tax certainty in international tax, and particularly in the application of transfer pricing rules, imposes significant costs on both tax administrations and taxpayers who spend significant time and scarce resources resolving disputes. Moreover, uncertainty has a negative impact on business confidence and the broader investment environment, slowing economic growth and stifling investment. For all these reasons, we strongly support the Inclusive Framework's efforts to provide greater dispute prevention and tax certainty.

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[2] Capitalized terms not defined herein have the meanings assigned to them in the Consultation Document and the Amount A Draft.

The following comments do not aim to be comprehensive, but rather focus on select areas to improve the tax certainty framework set forth in the Consultation Draft.

Respecting the October Statement's Commitments

We view with profound concern the ongoing disagreement within the Inclusive Framework that is described in footnote 3, regarding the scope of Related Issues and the application of Article 19 in cases where no bilateral tax treaty currently exists. With the October Statement, 137 members of the Inclusive Framework agreed not only to provide mandatory and binding mechanisms for related issues including transfer pricing and permanent establishment disputes, but also to create new treaty relationships to give this effect: "Where there is no tax treaty in force between parties, the [Multilateral Convention] will create the relationship necessary to ensure the effective implementation of all aspects of Amount A."

The expansion of taxing jurisdiction and the creation of multilateral taxing regimes that are encompassed in both the Pillar One and Pillar Two initiatives greatly increase the prospects for disputes between and among taxpayers and participating jurisdictions. For Pillar One, the determination of the quantum of Amount A for an In-Scope Taxpayer is relatively straightforward, but the allocation of Amount A between relieving and market jurisdictions is proving to be quite complicated. That allocation in many instances will be of greater import for affected jurisdictions than for taxpayers, who nevertheless will bear the primary burden of applying any agreed allocation mechanism. In this environment, a comprehensive certainty arrangement for the inputs into Amount A and the effect of other cross-border arrangements on Amount A, as well as for the implementation of the Amount A allocation itself, should not be optional, as the incidence of double taxation will proliferate without such guarantees. As evidenced by the October Statement, providing a mandatory and binding certainty process for Related Issues is essential to have an effective multilateral taxing initiative.

We believe that all of the potential reservations and other limitations discussed in footnote 3 are fundamentally inappropriate and incompatible with the October Statement. In particular, the suggestion that certainty for Related Issues does not need to be provided outside of existing treaty networks is particularly misguided. It is precisely for transactions between non-treaty partner jurisdictions that enhanced certainty is needed.

Existing treaty networks have large gaps that represent a significant portion of many MNEs' intercompany transactions– for instance, the United States lacks treaties with key business hubs (Singapore and Hong Kong) as well as most of the developing world (almost all of Africa, the Middle East, and Latin America). MNEs cannot (because of limitation on benefits provisions) and do not structure around these gaps; rather, they operate under conditions that are increasingly conducive to irremediable double taxation if certainty is not extended. In contrast, under existing treaties, the OECD's statistics show that MAP generally succeeds at eliminating double taxation. Providing a mandatory and binding backstop only to existing MAP articles, while welcome, would nevertheless leave taxpayers subject to unacceptable risks of double taxation and tax administrations with no viable means of resolution.

We also note that it will be necessary to include withholding tax issues (both with respect to whether a payment is subject to withholding tax and what withholding rate applies) within the definition of Related Issues, since withholding taxes will affect the computation of Amount A. This is acknowledged in the Amount A Draft, which notes that the certainty process will need to cover "the application of rules on the impact of withholding

taxes."[3] Expanding the definition of Related Issues in this way should be a welcome development – again, enhanced tax certainty benefits all stakeholders, not only taxpayers.

Lastly, the October Statement's commitment was not limited to a mandatory binding dispute resolution mechanism, but also extended to mandatory and binding dispute prevention for Related Issues. To give effect to this commitment, the Article 19 process should be made applicable to advance pricing agreement ("APA") requests that have not been resolved within a certain time (e.g., three years after sufficient information to substantively consider the case has been provided to the competent authorities). Expanding access to APAs would facilitate greater up-front certainty for taxpayers and tax administrations, and would reduce the challenges associated with making adjustments to Amount A following the resolution of a Related Issue.

Relationship with Amount A and Other Regimes

The Consultation Draft lays out a thorough proposal for a mandatory and binding dispute resolution mechanism, and we applaud the care that has been taken to provide clear and strict timeframes and default rules to prevent deadlock. However, this mechanism and the Amount A processes described in the Amount A Draft are far from sufficient to address all the issues that arise with respect to certainty.

Interactions between Related Issues, Amount A, and other regimes (including Amount B and Pillar Two) must be clearly addressed to provide effective certainty. The point of providing certainty for Related Issues is that they are related to Amount A, yet the Consultation Draft and the Amount A Draft do not contemplate how that relationship will be managed.

MAP and the Article 19 process will not resolve Related Issues for several years after the period to which the Related Issue relates. Requiring a taxpayer to go back and amend domestic tax returns for the years at issue (and very possibly also for intervening years) and requiring the relevant Coordinating Entity to amend Amount A returns for all affected years, would lead to administrative chaos, including administrative issues associated with granting and obtaining refunds. In line with the aim of Pillar One to provide simplifications where possible, it would be preferable to take into account adjustments with respect to Related Issues via telescoping, i.e., by reporting the amount of the income adjustment(s) for the year(s) at issue on the income tax and Amount A returns for the current year.[4] Telescoping is a well-established administrative practice commonly employed by competent authorities in MAP and APA cases, and it appears to offer the only workable solution to the problem of taking adjustments to Related Issues into account for Amount A purposes.

Expanding Access to Certainty

The Inclusive Framework has a generational opportunity to improve certainty in a way that will benefit all taxpayers, not only the largest enterprises, which in turn would benefit tax administrations and increase business and investor confidence in jurisdictions. The Multilateral Convention should draw from the example of the Multilateral Instrument and provide Parties with the option to extend the enhanced MAP article and/or Article 19 to their existing treaties, where they would apply to all taxpayers eligible to pursue MAP under the

[3] Paragraph 15 of section 2.3.
[4] Coordination rules will also need to address Related Issues that are resolved outside of MAP and the Article 19 process.

treaty. Of course, any such election would only come into effect with respect to a given treaty if elected by both treaty partners.

Changes to MAP: Coordination with Action 14 Improvements

Quite apart from the need for a mandatory and binding backstop to MAP, MAP processes themselves have many issues, notwithstanding their overall success at eliminating double tax in most cases. The OECD has already identified many of these issues and made a number of excellent proposals to address them in its public consultation document titled "BEPS Action 14: Making Dispute Resolution Mechanisms More Effective – 2020 Review," which was released on November 18, 2020 (the "Action 14 Draft").

Article [X] does provide important improvements vis-à-vis some existing MAP articles, namely the application of a three-year presentation timeframe, the elimination of treaty notification requirements (as confirmed by paragraph 21 of the commentary), the implementation of MAP outcomes notwithstanding domestic time limits, and the ability to submit a MAP request to either competent authority (although the latter improvement is, disappointingly, subject to disagreement). Yet there is much more that could be done. The Inclusive Framework should draw on the Action 14 Draft and the comments received in response thereto[5] to incorporate substantive improvements to MAP under the Multilateral Convention. In particular, we recommend that the Multilateral Convention provide for, among other improvements:

- A requirement that MAP resolutions be subject to roll-forward in a manner similar to that provided for in the accelerated competent authority procedure ("ACAP") that has been adopted by Canada and the United States;
- The elimination of transfer pricing secondary adjustments, which are not consistently applied throughout the world and create double tax risks and needless complexity;[6] and
- Suspension of the collection of tax pending a MAP or Article 19 process.

We urge the Inclusive Framework to embrace improvements to tax certainty, which will improve processes and outcomes for tax administrations as well as taxpayers.

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[5] KPMG International was pleased to have the opportunity to comment on the Action 14 Draft. *See* Comments on BEPS Action 14: Making Dispute Resolution Mechanisms More Effective – 2020 Review, submitted by KPMG International on January 8, 2021.
[6] *See* Sean Foley, Cameron Taheri & Lillie Sullivan, "Country-by-Country Survey of Global Secondary Adjustment Rules," Tax Notes Federal, July 5, 2021, https://www.taxnotes.com/tax-notes-today-federal/transfer-pricing/country-country-survey-global-secondary-adjustment-rules/2021/07/21/76qdw.

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