UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

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VIA EMAIL
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Re: USCIB comments on the OECD Public Consultation Document "Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing"

Dear Sir or Madam,

USCIB submits these comments in response to the OECD Public Consultation Document "Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing" (the "rules" or the "Document"). USCIB is a multi-industry sector US trade association that promotes open markets, competitiveness and innovation, sustainable development, and corporate responsibility. Its members comprise of leading U.S.-based global companies and professional advisory firms from every sector of the US economy, and which typically have operations in every region of the world.

In terms of Pillar One interest, USCIB's members include both Covered Groups and other multinational enterprises (MNEs) of all sizes. We are pleased to provide comments on this Document and the successive Pillar One Consultation Documents to be published. These Pillar One consultation rounds constitute the first meaningful input by USCIB on the Pillar One design rules, and we look forward to the further rounds of consultations. Our comments in this letter must be considered conditional pending the publication of all the draft model rules related to Pillar One. USCIB members are prepared to support further consultation suggestions for workable approaches that go beyond the initial reactions in this letter.

We recognize the work that the OECD Secretariat, the members of the Inclusive Framework on BEPS (the "IF"), the Task Force for the Digital Economy (TFDE), and the OECD technical working parties have invested in designing the rules for the implementation of Pillar One (collectively, the "drafters"). The comments herein generally reflect the consensus position of USCIB, unless otherwise provided.

Consultation Process is Welcome but Further Consultation is Needed

We note the drafters' desire for brief consultation periods for the Pillar One Consultation Documents but highlight the challenge for an organization of USCIB's size and sector representation to provide comprehensive comments under such time constraints. Not all interested members had the opportunity to contribute comprehensive comments to this letter in time. In addition, there has not been any time for members to conduct comprehensive compliance modeling for their respective businesses based on the rules, to validate our concerns regarding the rules' complexity. Although these concerns seem self-evident, we consider such modeling essential to an evaluation of the rules.

The drafters acknowledge at the outset that these rules do not "reflect consensus within the TFDE regarding the substance of the document." It is hoped that the comments and suggestions expressed in this letter will be seriously considered for the next version of the rules. We also have not had the benefit of reviewing these draft rules in the total context of the other Pillar One rules which have yet to be published (the so-called building blocks and the multilateral convention (MLC)). For these reasons we believe that further consultation will be necessary. USCIB and its members are prepared to work with the drafters on a reasonable timeline to identify a design that has the durability and sustainability to apply across the diverse business sectors that are in scope today and the millions of transactions that generate the revenue to be sourced for the Amount A allocation. We also offer our comments in light of the announced significant expansion of the Amount A income allocation system eight years from the effective date by reducing the global revenue threshold for groups from EUR 20 billion to EUR 10 billion. We consider this step more reason that the sourcing rules must be better aligned with commercial practice and simple allocation rules. Further drafter work should focus on the use of safe harbors that consider the reality of information available to Covered Groups in the normal course of commercial practice.

The largest MNEs in the world, the Covered Groups, would not be able to meet the requirements in the rules, overall, today or in the foreseeable future. In many cases, applicable laws and commercial contracts will preclude Covered Groups from obtaining information. Significant time and cost would be involved in establishing the financial systems necessary to meet the documentation requirements. The level of detail that the sourcing rules require would be disruptive to the commercial practice of Covered Groups and are sure to entail significant and unique costs of designing and implementing finance systems to do so, even before the rules have been proved.

Nexus Materiality and Complexity

The proposed bifurcated nexus thresholds of EUR 1 million and EUR 250 thousand should be increased considering the complexity of these sourcing rules. We consider these nexus thresholds to be too low for the level of complexity in applying the sourcing rules. We propose that further consideration be given to the use of an easy to administer allocation key for low revenue jurisdictions, if not on a wider scale. Allocation keys could be elective. With the global revenue threshold of EUR 20 billion, EUR 250 thousand represents 0.00125 percent of a Covered Group's revenue. At a threshold of EUR 250 thousand, the compliance cost to the MNE to source revenue to such a jurisdiction would be greater than the Amount A allocation itself and in some years there may not be an allocation when the threshold is not reached. At the worst, it may encourage both in scope and out of scope MNEs to avoid doing business in a low-income country under an Amount A cost-benefit analysis. If this low-level threshold is a Pillar One political decision that has little to no flexibility, an allocation key should be considered that satisfies a reasonable cost-benefit analysis and does not include the risk of bilateral and multilateral disputes involving those jurisdictions eager to ensure that the threshold will always be met because of the allocation at stake for such jurisdictions. Alternatively, we suggest permitting the election of an allocation key for any jurisdiction in which in scope revenue is below a (much higher) materiality threshold, such as EUR 500 million (which we note represents only 2.5% of the smallest Covered Group's revenue).

Sourcing Rules Complexity Disregards Commercial Realities

In considering the sourcing rules, which are heavily facts and circumstances based, we would like to emphasize some of the basic themes that guide our comments. A reasonable design of the sourcing rules is essential to the success of Pillar One. Rules that are fit for the purpose of reallocating Amount A should be consistent with the commercial realities of information gathering across multiple sectors, simple to administer for taxpayers and tax administrations, and be able to satisfy any reasonable cost benefit analysis for the rules considered, both separately and overall. The rules also must be evaluated considering the significant reduction in the Amount A in scope global revenue threshold to EUR 10 billion in 8 years from the effective date.

The drafters suggest that they have met such design standards, based on statements in the opening "Background" section in the Consultation Document. "The revenue sourcing rules have been designed to balance the need for accuracy with the need to limit compliance costs." Furthermore, the rules "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."

Notwithstanding the drafters' embrace of a standard based on "available information", the complex sourcing rules, on the whole, will impose significant implementation and compliance burdens on MNEs in order to source revenues down to immaterial amounts.

The proposal purports to "balance the need for accuracy with the need to limit compliance costs." Our view is this balance fails in a number of areas, not only to reasonably limit compliance costs, but also to provide workable rules that can actually be operationalized by taxpayers and effectively audited by tax administrations.

The proposed rules are complex, introduce significant subjectivity in application, and will be challenging to apply across companies and different product areas which will certainly have different data sets. This creates a significant potential for audit disputes and tax uncertainty. We reiterate the strong need for an early certainty process and binding dispute prevention and resolution mechanisms for all participating jurisdictions to ensure there will be effective resolution of definitional questions, methodologies, and determinations about the reliability of data sources.

Examples of the unnecessary excess include the expectation that revenue be sourced on an item-by-item basis. In addition to the initial compliance burden set by these requirements, the global nature of the Pillar One calculations results in a potentially exponential increase in audit information requests and inevitable controversy, which must be considered in the analysis of whether the right balance between administrability and effectiveness has been achieved.

Administrability for Taxpayers and Tax Administrations

The rules for nexus and revenue sourcing present a level of complexity that will make compliance by MNEs difficult if not impossible. The rules as currently drafted are too complicated, not easily audited and require documentation and systems not already in existence. Tracking transactions to the location of end users in many cases will be overly burdensome or impossible. The difficulty with tracking is heightened when dealing with Components as they are incorporated into final goods that many times are out of the control of relevant taxpayer.

The complexity of the rules may not be the only hinderance, however. The ability to provide and access the information necessary for compliance and enforcement can be an issue. Compliance may be impossible because of regulatory restrictions on disclosure of necessary information in relevant jurisdictions. Even where there are not regulatory limitations on disclosure, current business and tax documentation is insufficient to meet the requirements of the rules and will have to be enhanced and/or overhauled. To comply, Covered Groups may need to enhance, update or replace systems and will have to do so in a way that allows their systems to communicate with those of unrelated customers.

Given the limitations on information and the complexity, tax administrations will not be able to easily audit compliance by Covered Groups. Furthermore, given the low threshold under the nexus test, an overly complex system where incredibly detailed information is difficult to obtain (and may not be reliable) will likely not provide jurisdictions with a proportionate return on the time, effort, and financial investment it will take to enforce the rules.

Risk of Double and Multiple Taxation

Another challenge tax administrations and Covered Groups will face under the rules is the possibility that multiple jurisdictions will tax the same revenue. This risk will be enhanced once each jurisdiction implements its own interpretation of the rules. Double and even multiple taxation can lead to controversy not just between taxpayer and tax administration but between tax administrations. The double and multiple taxation risk raises several key questions. First, are tax authorities prepared to allocate the necessary resources to the competent authority function to deal with the resulting controversy? Next, how do tax authorities and taxpayers determine which jurisdictions should be at the table in both dispute prevention and dispute resolution processes? Finally, is the potential revenue worth the necessary investment to enhance the competent authority function?

While advance pricing agreements (APAs) have proven, over time, to be a good way to get tax certainty for complex transactions involving two or more jurisdictions and to mitigate the risk of double and multiple taxation, it may not be practical for a multi-jurisdictional review of these sourcing rules for the following reasons. First, the tax burden may not be material enough for a tax authority or taxpayer to engage in an APA. Second, the number of potential jurisdictions for which the nexus test will be satisfied may make an APA process ineffective. Third, potential limitations may be presented by the home jurisdiction's treaty network, unless otherwise addressed by provisions to be added in an MLC.

Relationship of the Rules to the Multilateral Convention (MLC).

As the MLC is in development and not available for us to review, there is significant uncertainty regarding what might be the strengths and weaknesses of any proposed panel review by up to 137 jurisdictions (theoretically) of a Covered Group’s compliance system. The ultimate nexus and sourcing rules agreed will determine how they will be reviewed as part of the MLC process. Yet it is already difficult, based on these rules’ complexity, to imagine how that part of the process would look for establishing taxpayer certainty in a way that would ensure any MNE is compliant from the effective date of Amount A.

Jurisdictions “could use” these rules and “will be free to adapt these [final] Model Rules”. This overall structure raises the very real possibility that Pillar 1 becomes a patchwork of rules similar to DSTs. This places critical importance on which rules are in the MLC and which rules are in the final Model Rules and Commentary. While we recognize that the MLC simply cannot contain every Pillar 1 rule, we recommend that the MLC contain as much detail as practically possible, because the more substance that is left to the Model Rules and the Commentary, the more Pillar 1 becomes a patchwork of rules across jurisdictions. This is especially an issue for nexus and revenue sourcing because different rules in different jurisdictions will lead to double taxation. The drafters should consider requiring enactment of the final Model Rules as mandatory (similar to the MLC itself) in order for a jurisdiction to get the benefits of Pillar 1, e.g., a revenue allocation.

The Risks to Pillar One by Expanding the Scope of Amount A in Eight Years

We cannot overstate our concern regarding the sustainability of these rules for the initial 8 years of the system and when the global revenue threshold is then reduced from EUR 20 billion to EUR 10 billion. This expansion of the Amount A allocation system could add thousands of MNEs to Covered Group status. It is difficult to imagine the confusion and instability taxpayers and tax authorities will experience if the threshold is reduced, on top of a transition period of implementation in the first 8 years of the system. Streamlined and easy to administer sourcing rules that are consistent with commercial realities, simple to administer, provide certainty and involve reasonable cost will smooth the path to a reasonable transition for impacted MNEs when the threshold is lowered.

Before Pillar One is expanded beyond the original scope to cover additional companies, the drafters should conduct a public cost-benefit study of the utility of incremental revenue sourcing requirements, including consideration of how best to leverage the facts and circumstances-based sourcing rules for a broader set of taxpayers.

Stepping back, the political agreement to reduce the revenue threshold is contingent on successful implementation of Amount A during the first seven years, including with respect to the tax certainty process. Thus, jurisdictions that favor expanding the number of in-scope companies have a stake in designing simplified revenue sourcing rules that are administrable and that will not lead to needless disputes between tax authorities and taxpayers. As presently drafted, the revenue sourcing rules, including their reliance on subjective standards like “reasonable steps” to undertake what will in many cases be futile inquiries, will put immense pressure on a tax certainty and increase the odds of failure under the process.

Implementation Timeline

The rules lean heavily towards a facts and circumstances orientation. Therefore, at a minimum, it warrants a two or more years transition period, in which an MNE should be able to rely upon its existing systems and information for sourcing. We view this as a “best efforts” approach. Systems changes should not be required until an MNE has received confirmation of an alignment of the MNE facts to the sourcing rules under the early certainty process. In addition to the time that will take, MNEs will need time to design, secure budget, and implement systems changes based on the outcome of the early certainty process.

Certainty and Administration (Use of Samples and Proxies)

Part 3 (B)(2): The sourcing rule requires place of delivery of the finished goods to the final customer. Propose a simplifying safe harbor election that would permit an MNE to generally source finished goods sold through third party distributors or retailers to the ship to location.

Additionally, there are numerous situations where the volume of data will be overwhelming under a transaction-by-transaction approach. Many Covered Groups have tens of thousands of reseller agreements and millions of end customers. If MNEs are required to follow transaction-by-transaction sourcing rules that resemble the rules included in the consultation document, MNEs will need time to procure budget and make systems changes to automate the work. There are also aspects of the current proposal that may always require a manual process, such as reviewing thousands of nonconforming distributor agreements for whether they include territorial restrictions. In any case where the volume of information is large, and an analysis of each transaction would be impractical and overly burdensome, statistical sampling ("stat sampling") should be permitted. For example, stat sampling should be available for reviewing individual distribution or license agreements for territorial restrictions. Similarly, if the proposed approach to business-to-business ("B2B") services is retained, stat sampling should be available for establishing whether a customer is a large business customer and, if so, the jurisdiction of its ultimate parent entity (UPE).

The United States has significant experience with allowing taxpayers to use stat sampling, including in situations where taxpayers have the burden of affirmatively establishing the treatment of transactions on their income tax returns. See, for example, Rev. Proc. 2011-35, 2011-25 I.R.B. 890 (providing safe harbor methodologies to determine basis in stock acquired in transactions with carryover basis); Rev. Proc. 2004-29, 2004-1 C.B. 918 (providing the stat sampling methodology that a taxpayer may use in establishing the amount of substantiated meal and entertainment expenses that are excepted from section 274(n)(1) (the 50% disallowance of deductions for meals and entertainment)); Rev. Proc. 2007-35, 2007-1 C.B. 1349 (addressing when stat sampling may be used for purposes of section 199 (income attributable to domestic production activities)); Rev. Proc. 2002-55, 2002-2 C.B. 435 (permitting external auditors of qualified intermediaries to use stat sampling); and Rev. Proc. 72-36, 1972-2 C.B. 771 (setting forth stat sampling guidelines for determining the redemption rate of trading stamps).

In addition, Rev Proc. 2011-42, 2011-37 I.R.B. 318 provides that stat sampling, as described in that procedure, is generally appropriate in other circumstances, based on factors such as the time required to analyze large volumes of data, the cost of analyzing data, and the absence of other books and records that may independently exist or have greater probative value. Many U.S. companies regularly follow this procedure for other tax compliance purposes, including for purposes of documenting end markets under the U.S. regime for foreign derived intangible income (FDII).

In addition, in the bilateral context, the 2006 U.S.- German Protocol amending the tax treaty between the United States and Germany, contemplates the use of stat sampling to satisfy the limitation on benefits article. Specifically, the protocol would allow certain German investment funds to be treated as residents eligible to claim treaty benefits provided that at least 90 percent of the shares or beneficial interest in the fund are owned, directly or indirectly, by certain German investors or equivalent beneficiaries. The protocol also provided that the competent authorities shall establish procedures for determining whether the 90 percent ownership threshold is satisfied, including through indirect ownership. The protocol anticipated that the competent authority "…procedures may include the use of statistically valid sampling techniques."

Ultimately, MNEs should have the flexibility to balance the costs and benefits of different approaches, using their judgment and understanding of the information available to them, rather than being required to follow prescriptive rules.

Specific Comments to Title 4, Nexus and Revenue Sourcing

Title 4: Nexus and Source Rules

Article [X]: Nexus test

A nexus threshold pegged to overall Covered Group revenue would be appropriate, even at a vanishingly small 0.1%. Considering the revenue impact to market countries, setting the threshold at EUR 250 thousand will result in tax compliance burdens (for both taxpayers and tax administrations) resulting in tax obligations of perhaps EUR 10 thousand per Covered Group (and in many cases far less), assuming 20% before tax margins and a 40% local tax rate. In this example, the compliance cost alone could easily be higher than the tax revenues obtained by market jurisdictions, leaving aside the personnel, technical and advisory costs for the management of inquiries related to these filings at any point in the audit cycle.

The nexus threshold should be established at a level of at least EUR 10 million and indexed for inflation using the index in the Covered Group's home country jurisdiction. This threshold would achieve the goal of limiting nexus to cases that are "material" (as stated in the Background section to the rules: "The thresholds ensure that the nexus test is only satisfied when the amount of revenue of a Covered Group derives from a jurisdiction is material."). A simple comparison of the thresholds for Covered Groups clearly shows that the proposed thresholds of EUR 1 million / 250 thousand are not even close to material or even "deemed" material thresholds.

Article [X]: Source rules

The rules set the expectation that transactions will be sourced at an item-by-item level. This is not administratively achievable (or desirable) and sets up unreasonable expectations on audit. Tax compliance under both domestic income tax law and Amount A begins with the Covered Group's financial statements. The financial statements aggregate the results of hundreds of thousands (if not millions) of separate transactions. These results may be recorded, tracked, and audited in a variety of systems and ledgers which are consolidated or aggregated to prepare legal entity or consolidated financial statements. In addition, MNEs have multiple commercial, fiscal, and regulatory interests to maintain documentation to establish revenue source of their financial statement results. Sourcing interests will vary by enterprise, sector, and business model, e.g., financial accounting purposes, legal liability, strategic business decision-making, local and parent level national and subnational tax compliance, employee and third-party incentive purposes, etc. We understand, however, that the transaction level detail that the rules require is not routinely captured and used by corporate tax departments. Imposing this as a standard requirement creates an enormous compliance burden and an impossible standard to meet on audit. There is no clear rationale articulated in the Document as to why a more reasonable method would not be sufficient. A reasonable method must be used to determine revenue sourcing. A variety of data sources exist (although varying by enterprise) to appropriately determine the source of revenues. It is unlikely that an item-by-item approach will yield a more accurate result assuming there will be limited segmentation of business level results.

The rules must establish a clear process and limitations on how sourcing may be audited. Under Pillar One, all revenues from all entities must be sourced under the rules, and in some cases apportioned under a variety of factors. Thus, potentially every sales transaction of a Covered Group, from whatever source or entity, is the subject of inquiry or audit demands from every jurisdiction participating in Pillar One (in theory, up to 137 countries).

Under these circumstances, establishing a single jurisdiction (the Lead Tax Authority of the UPE) with responsibility to assess and validate sourcing with an early certainty process will minimize the unreasonable burden that would be created by potentially limitless audit demands from multiple jurisdictions requiring proof of sourcing. In addition, the varying audit statute of limitations rules in different jurisdictions potentially put an unsustainable burden on companies for information retention. Current document retention by companies is already costly. It generally requires maintenance of fewer documents and datasets, however. Retaining the vastly larger dataset contemplated by Pillar One until the statute of limitations expires in the jurisdiction with the longest such statute would create unmanageable costs simply due to the additional data storage periods required.

Accept Commercial Reality and Eliminate Disruptive Compliance Burdens

A Covered Group should be able to use data that it possesses in the ordinary course of commercial practice as part of its revenue sourcing requirements. These commercial practices are well established in the different business models that relate to the income categories listed in the rules. For example, it is normally not common commercial practice to request information from unrelated third-party businesses regarding the source of resale or the further distribution of goods and services as finished goods or components. To have to begin to do so for this narrow purpose would likely be significantly disruptive to commercial relations and therefore an intolerable risk to the MNE business. In practice, third parties largely resist disclosing such information for any number of reasons. Examples of this data include the impression location for ads, interface data for business-to-business (“B2B”) cloud services, and warranty registration data for B2B sales described below. In that regard, wherever a list of indicators is provided, the MNE 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 can evolve over time in response to industry and regulatory changes.

In contrast, requiring MNEs to request the headcount by location of customers, and any other metric that would require customers to provide to the MNE their non-public business data, is inappropriate. Customers will not be willing to provide this because it would be burdensome on them and reveal confidential information. It also makes MNE compliance dependent on unrelated third parties that are not under the control of the taxpayer. Thus, MNEs should not be required to “take reasonable steps” to ask their customers (which number in the thousands or even millions) for non-public information about their operations because it will be a waste of resources that will only give rise to controversy regarding what steps are reasonable in the context of an unreasonable and futile exercise. Accordingly, to the extent that documentation options require the use of third-party data (e.g., the Large Business Customers of a B2B service), these options should be, under the best of circumstances, elective because it is not commercially practical, and it inappropriately interferes with third-party business relationships of the MNE.

Second, companies should not be required to build out expensive, time consuming systems and processes simply to source these transactions without other business value. In that regard, the “Knock-out Rule”, under which companies using an allocation key must regularly identify jurisdictions in which no revenue arises, is unrealistic and burdensome. No taxpayer, at the transactional scale of Amount A, will be able to reasonably perform on a regular basis a contractual analysis customer by customer to apply the Knock-Out Rule.

Moreover, requiring companies to review contractual data for transactions or customers is unreasonable. This information typically is not organized and stored in systems and normal contractual terms 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 or countries within Asia. Further, Covered Groups of this scale have millions of non-conforming customer contracts. This level of granularity should never be required. Capturing this data is not systematically scalable.

The level of complexity involved in categorizing each transaction, selecting a method for sourcing each such transaction, and then applying the relevant sourcing rule to the revenue from such transaction counsels in favor of permitting taxpayers to elect to apply group-level simplified methods to allocate Amount A reliably.

Transaction by transaction.

There are many situations in which transaction-specific data identifying the precise location of a final consumer or the employees of a business customer is simply not attainable (and asking the customer for more information is not commercially or legally practical, as discussed above). The legal framework for implementing Amount A should recognize and address this fact in a practical way. These situations include, but are by no means limited to, MNEs that sell goods or services (including, but not limited to, digitally delivered goods and services) through third party channels and MNEs that sell intangible products or services to businesses. The difficulty with transactional analysis is not limited to obtaining and analyzing the data, but also the volume of data that may be involved.

For example, we understand there are multiple in-scope companies that have tens of thousands of resellers and millions of business end customers that have employees. In turn, the largest distributors and resellers may each have thousands (if not hundreds of thousands) of end customers. It simply is not feasible to collect end-customer information (a listed sourcing indicator) regarding the “place of use” of B2B resold services as required under the B2B reseller sourcing proposal. The volume of information is too large to process on a transaction-by-transaction basis for all these customers. The collection and analysis of additional transaction-by-transaction level data would require significant additional time and resources to the extent that it is possible at all. This additional time and resources to comply and administer these sourcing rules will be compounded as in-scope companies are expanded into the thousands. This highlights the importance of permitting MNEs to source revenue based on existing information of the MNE or that is publicly available and accessible. Accordingly, the final Model Rules should permit MNEs to source revenue pursuant to an allocation key based on information available to them, provided that the key produces results that are consistent with the general sourcing rule for the transaction at issue, without having to first establish that no Reliable Indicators are available. This approach would be similar to what the Draft Model Rules would permit for transportation services. An example of a company-specific allocation key that could be used for companies that earn revenue from online advertising is described below.

Sourcing on a transaction-by-transaction basis 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. Further, requiring ratios based on every type of monetization approach separately is also unrealistically burdensome and is not consistent with commercial practice.

De minimis treatment for small lines of businesses

In addition, many in-scope MNEs also run, in effect, relatively small businesses that are in entirely different industries from the MNE's main lines of business. These secondary lines of businesses may be "start-ups," legacies of acquisitions, or complementary to the main businesses. The costs of implementing business processes and other systems to source the revenue from these secondary businesses would be disproportionate to the amount of revenue and profit involved. A significant burden could be eliminated if MNEs could avoid adopting sourcing methodologies and building systems to source small amounts of revenue from these secondary businesses, which would generally not be expected to meaningfully contribute to the residual profits allocated under Amount A.

The Document proposes that noncustomer revenue (such as interest earned other than in a lending business) be sourced in proportion to the other revenue for which sourcing rules are provided. The final Model Rules should provide a similar result for secondary businesses. This would simplify compliance without contravening the goal of the revenue sourcing rules to accurately identify the market jurisdiction and the associated revenue. Secondary businesses could be defined as those that represent less than a specified percentage of the MNE's total revenue, those that generate revenue of less than an absolute Euro amount, or those that have a low profit margin. Revenue from secondary businesses could be sourced in proportion to the revenue from the most adjacent or closely aligned revenue stream for which the sourcing rules apply, or in proportion to all other revenue for which the sourcing rules apply.

Schedule A Detailed Revenue Sourcing Rules

Part 1 Categorizing Transactions

The rules identify approximately 25 different categories of transactions (depending on how precisely one counts), each category with their own rules for determining the source of the revenue from such transactions – either based on one or more Reliable Indicators of source, or, in the absence of a Reliable Indicator, based on one or more available allocation keys.

The policy rationale is not readily apparent from the rules, for both the precise delineation of the categories and the corresponding sourcing rules. For example, the rules provide a single category (and a single sourcing rule) for the sales of final goods, whether the good is sold to a business or a consumer. Services, on the other hand, are sourced differently depending on whether provided to a business or to a consumer. As a further complexity, component goods are placed in a separate category from final goods, but there is no similar rule for "component" services, unless the services qualify as business-to-business service sold through a reseller. Conversely, the rationale is not clear in the rules for separate categories, with different sourcing rules, for passenger transport and cargo transport.

Likewise, services performed on-site at the customer location are categorized differently from services performed offsite, apparently without regard to whether there is anything in the nature of the services that might distinguish the two.

In other instances, it is unclear into which category certain transactions fit. For example, the draft provides different sourcing rules for business-to-business services and advertising services. Advertising services are defined as "the provision or facilitation of advertising." It is unclear which marketing-related, business-to-business services qualify as "general" business services and not advertising services.

The distinction can result in significantly different revenue sourcing.   Likewise, what qualifies as a final good (one sourcing rule), a component good (different sourcing rule), or an intermediate good (no rule at all), is often uncertain.

In addition to the above concerns, as the rules recognize, in many instances a transaction which may be treated as a single transaction under commercial practice today, may fall into multiple categories under the rules. In this case an analysis of the "predominant character" of the transaction is required. In the first instance, a taxpayer must identify (and involve tax authorities in the interested jurisdictions) the scope of the transaction. Whether a transaction with multiple features is a single transaction to which a single sourcing rule applies (and if so, which one), or is instead divisible into multiple transactions subject to multiple sourcing rules (and whether supplementary transactions are involved) is another potential source of uncertainty and controversy.

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.

In the example on online advertising, the footnote alternates between referring to viewers and users 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 doesn't 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.

Finally, notwithstanding the current list of transaction categories in the draft, new business models will arise over time requiring additional categories of transactions and the attendant additional complexity associated if the granularity of these rules is retained.

Part 2 – Reliable Method

USCIB acknowledges the flexibility the consultation document provides on possible methodologies and urges the drafters to seek simpler and more administrable methodologies. The rules do not contain a hierarchy of methods, which is a welcome change. However, they also do not provide certainty that a Covered Group can rely on one reliable method if other jurisdictions seek to impose or use other reliable methods. For example, the definition of "reliable indicator" is inherently subjective, requiring the Covered Group to establish that it sources revenue consistent with the sourcing rule for the particular transaction. The rules should be clarified to make clear that Covered Groups can rely on any listed indicator (i.e., standard should be clarified that all that is required is "a" reliable indicator, rather than a "best method" standard that could be disputed).

A Reliable Indicator (including one applied using sampling or other statistical methods to estimate the sourcing of a large population of transactions) meeting the criteria outlined in the rules should not be subject to challenge by tax authorities who prefer a different Reliable Indicator. The rules should be clarified such that a Covered Group's chosen method raises a rebuttable presumption of correctness and sets, if any, a high evidentiary bar for the interested tax authorities to challenge. Otherwise, Covered Groups will not have tax certainty on the amount to be allocated to respective jurisdictions.

The reliability of the Covered Group's method should be approved in advance but only after the Covered Group has had the benefit of a transition period to implement necessary changes or otherwise update existing systems to apply the rules. The final Model Rules should provide that an MNE will be permitted to source revenue based on existing data in its possession or otherwise publicly available for two years or the completion of the early certainty process, whichever is later, plus the time needed for MNEs to implement the changes. Many MNEs will be unable to comply with the rules if they are required to obtain information from their customers that they do not currently collect due to the number of customers they serve or independent distributors and resellers they use. For these MNEs, it is far more appropriate to determine what "reasonable steps" entail in collaboration with the relevant tax authorities so that the determination of reasonable can be based on the MNE's actual facts and circumstances. Another approach is to consider a prospective ruling program, similar to a private letter ruling that provides taxpayer certainty for the use of a specified reliable method. By allowing this flexibility for the Covered Group, best methods will emerge more quickly which in some cases could be scaled across Covered Groups during the experience made when Amount A goes into effect.

In the absence of significant deference to a Covered Group's choice of a Reliable Indicator, presumably many Covered Groups would prefer to utilize a regional, global, or low-income allocation key. The choice of a Reliable Indicator could be challenged on at least two bases, first, that it was an inappropriate indicator or second, that some of the data reported was inaccurate. In many if not most cases use of a simple allocation key would be far preferable to some businesses.

The reference to the process for selection of Reliable Indicators and control framework should not be interpreted in a way that requires financial statement controls based on materiality as assessed against the nexus thresholds. For example, Pillar One establishes an allocation nexus at EUR 250,000 in sales, which is far below a materiality threshold for Covered Groups subject to Pillar One. The term 'Internal Control Framework' might be deemed to create US Sarbanes-Oxley (SOX) or other compliance expectations pegged to this number, which would potentially have ramifications beyond Pillar One.

The expectation that a Reliable Indicator be used consistently should be clarified – many enterprises will have different data availability for different business and/or entities, driven by systems availability, business need, etc. This might be the case even for a common business if multiple entities engage in third party transactions. Note that if poorly defined, the requirement that a Reliable Indicator be consistently used and available might result in a determination that there was no Reliable Indicator, thereby requiring increased use of allocation keys.

This section provides rules for determining "Another Reliable Indicator," but requires the indicator to "meet the requirements of paragraph 3", which contains the primary rules for determining a Reliable Indicator. This seems circular, as apparently nothing can qualify as Another Reliable Indicator that is not already a Reliable Indicator. Suggest deleting "provided the information meets the requirements of paragraph 3".

There are likely to be multiple applicable Reliable Indicators, some of which may be conflicting due to the nature of the information obtained, but the Rules are unclear which to use in that case. The rules should clarify that where there are multiple Reliable Indicators, the taxpayer has the option to choose among them.

It should be made clear that the hierarchy in Part 2, Section 3.b.ii of the rules does not require businesses to secure information from third parties incremental to their existing business needs (i.e., the reliable indicator requirement should not impose a new data-collection and reporting obligation on MNEs and third parties where that data is not currently collected and used for business needs, although this seems to be contemplated in the LBC Headcount Allocation Key discussed below in the Business to Business Services discussion.)

The rules should allow Covered Groups to elect to use as a Reliable Method an Allocation Key that is based on published data sources, be it government, academic or industry. This would ensure that both Covered Groups and tax administrations secure the significant advantage of a simple, reliable, sustainable, and user-friendly process to implement the Amount A allocation. This approach can achieve the following:

- Respects that gross revenues and profits, by market jurisdiction, might not otherwise be aligned.
- Is readily useful for financial reporting and tax administration review purposes.
- Would substantially simplify the application of Pillar I in multiple respects (e.g., avoid wholesale global systems rewrites, minimize tax controversy, allow Covered Groups to make Amount A tax payments sooner and on more predicable bases to the market jurisdictions and, in an Independent Distributor/Reseller/B2B context, eliminate the drag on necessary data gathering of proprietary or legally protected data).
- This Proxy Allocation Key could be further validated as follows—
    - Subject to preclearance through the early certainty process.
    - Under a transition rule that respects good faith conduct and/or best efforts by the Covered Group to develop a reliable system over an interim period while still being treated or deemed as compliant for Amount A allocation purposes.
- For example, require a defined period for use of such Proxy Allocation Key of say [3 or 4] years unless the Covered Group is subject to material changes such as a 'change in ownership' for example, [50]% or more change among its [> 10]% shareholders.

There should be clear guidelines as to the methods that Covered Groups in different industries can use, which should provide that, if the method is accepted in the early certainty process, it should be accepted in all jurisdictions for that Covered Group. It is important to have consistent rules for Covered Groups that provide a level of comfort with respect to their chosen method. It would impose a significant burden and double tax on companies if they were required to use different methods in different jurisdictions.

The draft rules are an improvement from prior concepts but still have the potential to create significant administrative cost relative to the potential tax paid to an Amount A jurisdiction where the taxpayer currently does not have a taxable income tax presence. The proposed rules also raise concerns that disagreements over alternative reasonable approaches to estimate destination consumption sale jurisdictions. We respectively submit that the MNE's within scope of Amount A should be able to comply with the revenue sourcing objectives utilizing an alternative elective formulaic method. Such an approach must ensure that the Amount A sales are globally fully accounted for and that the simplified safe harbor method reasonably estimates the intended revenue sourcing approach while dramatically simplifying the administrative costs of revenue sourcing and eliminating tax uncertainty in this area.

As Appendices A through C to this letter, we describe three different safe harbor methodologies for illustrative purposes, without prejudice: the Global Allocation, the Covered Group Market Characteristics, and the Simplified Finished Goods Revenue Sourcing Approach. These methodologies are intended to be elective for the Covered Group.

For example, under the Appendix C approach, the MNE within scope would first identify and place in an allocation pool all its sales that are exported from a jurisdiction where it has a taxable presence to any jurisdiction where it currently does not have a general taxable presence. Additionally, an agreed proportion of sales in all taxable presence jurisdictions would be deemed reexported to market jurisdictions where the MNE does not have a general taxable presence. Possible methods and rationales to determine the amount deemed reexported is further explained in Appendix C. Total exported sales (step one) and deemed exported sales (step two) to jurisdictions where the MNE does not have a taxable presence would be combined and allocated proportionately to all market jurisdictions where the MNE does not have a traditional taxable presence based on either the jurisdictions' relative GDP of this group of jurisdictions or relative national consumption data as supplied by the OECD. To ensure that the election does not produce an over or under allocation, the amount allocated to any non-taxable presence would have a cap (125% of the average) and guaranteed minimum (75% of the average) calculated as a function of the MNE's average sales in the ten smallest jurisdictions where the MNE has a taxable presence. Where the cap or minimum are applicable the deemed sales percentage is proportionately adjusted.

Part 3 - Finished Goods

Revenues from Finished Goods sold to Final Customers directly by a Covered Group or through an Independent Distributor.

It may not always be apparent to a Covered Group where the Final Customer is when finished goods are sold through an independent distributor. Is it realistic that the companies would have access to the reliable indicators. If current practice of a company is not to obtain the information set out in B.1-3, how much effort should be required by the company to obtain such information. Companies should be able to use an allocation key if estimated revenues in a jurisdiction are below a certain amount (see comments under Nexus).

Part 3, Section B.3.b seems to result in tail-end revenues not identified as Regional Revenues being allocated solely to Low-Income Jurisdictions. Only if the Covered Group demonstrates that Revenues did not arise in any Low-Income jurisdictions is the Global Allocation Key used. If this is not the intent, this should be clarified. Also note that 'Region' is broadly defined (appropriately) but would include a 'near-global' grouping (e.g., all countries other than Cuba & Iran would represent a region under this definition). Given this definition of Region, the rule of B.3.b would presumably never apply.

The final Model Rules should clarify that Covered Groups may make reasonable assumptions in applying the Regional Allocation Key. The commentary should include examples demonstrating when a Regional Allocation Key be used, such as where:

- The cost of shipping makes it unlikely that the goods will be sold outside the region; or
- The Covered Group has independent distributors in all major regions of the world, making it unlikely that a distributor in one region would find it economical to compete with a distributor in another region to a significant degree.

Covered Groups should not be required to establish that there is no Reliable Indicator on a transaction-by-transaction basis before using the Regional Allocation Key, at least in circumstances where the MNE sells through more than a few independent distributors. Covered Groups should be permitted to establish the appropriateness of using the Regional Allocation Key for categories of transactions based on their understanding of the market or by examining a sample of transactions.

The rules do not provide guidance on how a region should be grouped for purposes of applying the Regional Allocation Key. Covered Groups should be allowed flexibility to determine the appropriate groupings for a region in applying the Regional Allocation Key. For example, an approach that defines regions in the same way that the Covered Group defines regions for internal management or reporting purposes should be deemed to be reasonable, but not required.

Revenues from digital goods

There may be no data or at best limited data available to Covered Groups regarding the location where a digital good is used, and the available indicators may be inconsistent or inaccurate.

Tail End Revenues

The concept of Tail End Revenues addresses cases where a taxpayer is unable to gather reliable data about the last 5% of revenues for a transaction. While this is helpful, there is a far more compelling issue related to tail end revenue, and that is that systems for compliance (in the best of cases) will be expensive and require significant resources to implement, manage, and upgrade, solely for this purpose. Covered Groups cannot develop systems for every single product in existence for any given year without extremely disproportionate costs. These companies should be able to use billing address for amounts that represent 10% or less of the company's total revenues from third parties (e.g., products with total revenue under this threshold), 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 revenues 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.

The rules provide that an MNE with Tail End Revenue of 5% or more must take reasonable steps to reduce the Tail End Revenue arising in later periods. An MNE that does not take such steps within two periods after the first period in which the Tail End Revenue was 5% or more may be subject to penalties for failure to comply.

Consequences of failure to take reasonable efforts to reduce the 5% threshold are not clear, though the draft states in footnote 16 that penalties would apply. Some companies may be indifferent to the results of allocation such that use of global/regional allocation keys for sourcing Tail End Revenue is far preferable from a cost standpoint to developing systems and architecture to collect, retain, and defend more specific data for sourcing tail end revenue. (Particularly without any limitations on the ability of jurisdictions to challenge the use of a given reliable indicator by an MNE.)

Five percent seems inappropriate for Tail End Revenues across the board. The Tail End Revenue threshold could vary by category as it may be particularly difficult to obtain the requisite information for companies in certain categories.

There is no policy support for imposing a penalty for failing to take reasonable steps to reduce Tail End Revenue, given the OECD's acknowledgement that Covered Groups often do not have access to information regarding the location of the final customer for goods sold through independent distributors and the suggestion that, as discussed above, an indicator obtained solely for purpose of applying the rules may not be considered a Reliable Indicator.

The final Model Rules should not impose penalties on any MNE that makes a good faith effort to comply with the revenue sourcing rules. Where Tail End Revenue exceeds 5%, a more reasonable approach would be to allocate 5% of revenue according to the Low-Income Country Allocation Key and the remainder according to either the Regional Allocation Key or the Global Allocation Key, whichever is more appropriate under the circumstances.

Prior comments from the Secretariat suggested a concern that the use of imprecise indicators to allocate revenue from independent distributors may under-allocate revenue to small jurisdictions where distributors are less likely to have a presence. The definition of Low Income Jurisdiction, however, includes some large jurisdictions where MNEs (especially the MNEs that are in scope for Pillar One) can be expected to have well-developed distribution networks. For example, the definition would currently include India and Indonesia, both G20 countries, as Low Income Jurisdictions. Accordingly, the definition of "Low Income Jurisdiction" should be limited to smaller markets where independent distributors are less likely to have a presence. This could be done by imposing a GDP cap on the jurisdictions included in the key.

Further, as currently drafted, Tail End Revenue could be allocated to a Low Income Jurisdiction even if income is also allocated to the Low Income Jurisdiction using a Reliable Indicator or the Regional Allocation Key. The final Model Rules should include a rule to eliminate opportunities for a jurisdiction to benefit from Tail End Revenue to the extent the jurisdiction was already allocated revenue based on a Reliable Indicator or Regional Allocation Key. This rule could cap the allocation to the greater of what the jurisdiction would be entitled to using the Reliable Indicator, Regional Allocation Key, or the Low Income Jurisdiction Allocation Key.

Part 4 – Components

Revenues from components

Requiring component manufacturers to determine revenues based on the final customer of the final finished good places an undue burden and impossible standard for component manufacturers to reasonably comply. The OECD previously acknowledged this challenge in its January 31, 2020 statement, taking into account practical realities, "businesses selling intermediate products and components that are incorporated into a finished product sold to consumers would be out of scope".

For example, components like semiconductors are sold in bulk and incorporated and substantially transformed by unrelated parties into an altogether different product (e.g., a mobile phone, a computer) 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 does not know the location of the third-party's Finished Good to the Final Customer.

Without the ability to access the destination of the Finished Goods, it is impossible for a Component manufacturer to determine the location where the Finished Good is sold to the Final Customer. As discussed above, companies should not be required to access information collected by another taxpayer (such as a customer or a customer's customer) to determine sourcing.

The sourcing rules for components parts need to be revised to a standard that can reasonably and practically met. Therefore, 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 of the Finished Good and the manufacture/seller of the Finished Good."

As the primary rule is that revenue must be sourced on a transaction-by-transaction basis according to revenue earned from the transaction, the sold to information is the most reliable and reasonable indicator that the component manufacturer 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 that Jurisdiction is the place of delivery to the direct customer of the manufacturer of the Finished Good into which the Component is incorporated." While the "sold to" information is the most verifiable information the component manufacturer receives with respect to the use of its product by a third-party, at a minimum, the component manufacturer should only have responsibility to the third-party from which it directly derives revenues.

4.A.3: Where a Reliable Indicator may not exist for component sales, it may nonetheless be possible to determine a Region for purposes of a Regional Allocation Key (for example, so-called Tier IV emissions engines are generally only sold in markets requiring Tier IV emissions certification). The rationale for applying a different hierarchy of potential allocations in this case from the rule for finished goods is unclear and unnecessarily complex. The rules do not provide or permit the use of a Regional Allocation Key in the absence of a Reliable Indicator.

The same concerns for direct component sales apply to sales made through Independent Distributors. Covered Groups may not currently obtain such information and such information may not be readily available based on contractual arrangements and established commercial practice.

Part 5 – Services

Revenues from location-specific services and services connected to tangible property

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 or electronic activations. Companies may not be able to relate this location data with revenue data because, for example, this data may not be used by billing systems in the ordinary course of business. In that case, companies should be able to use this location data to compute an overall location ratio that can be applied with respect to all B2B sales at the company level instead of the customer level.

Revenues from advertising services

Online advertising services

Generating the granularity of the data required goes beyond the scope of commercial practice. There is a large amount of data required (clicks and impressions in the billions), and there are questions about the systems in place to track click-by-click or impression-by-impression data.

Some business models charge per click, others by impression, and other by cost per acquisition, and these models may change in the future. Companies should be permitted to choose a consistently applied approach that reflects the location data they have, without significant new systems setups. 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 / multifactor). To avoid duplication of compliance requirements, limit unnecessary costs, and reduce needless disputes, there should be a safe harbor for any methodology that establishes location in a similar manner required for any other tax compliance purpose.

Similar issues arise with digital goods in that it is possible to have conflicting information. In addition, there should be a requirement of consistency by jurisdictions – if a particular methodology is found to be acceptable in the early certainty process, the same methodology should be used in all jurisdictions.

In the case of online advertising revenue earned by targeting ads at users of an online platform, internal proxies should be permitted to source revenue to the location of users where such proxies can be expected to approximate the same result as a transaction-by-transaction approach. In many cases such a proxy could leverage information the company currently uses internally for management reporting purposes. Moreover, this would give companies flexibility to build a framework for sourcing revenue that will work in the long run. This would be a much more workable and durable solution than requiring a transaction-by-transaction analysis.

This approach would be similar to what the rules allow for transportation, where MNEs are permitted to use an alternative Allocation Key. For example, for cargo air transportation, MNEs would use a key determined as:

- The sum of the cargo weight transported by an MNE in a period from a place of take-off in a Jurisdiction and the cargo weight transported by an MNE in a period to a place of landing in a jurisdiction; divided by
- The sum of the cargo weight transported by an MNE in a period from places of take-off in all jurisdictions plus the cargo weight transported by the MNE in a period to places of landing in all jurisdictions.

Revenues from Transport Services

The rules for Non-air Transport Services provide that such revenues are deemed to occur in the Place of Destination of the passenger. This rule does not account for the fact that most international shipping income is earned on the high seas rather than in any jurisdiction. This position is reflected in Article 8 of the OECD Model Tax Convention, in almost all income tax treaties and in the October 2020 Pillar One Blueprint which stated it was inappropriate to apply Pillar One to international shipping activity. It is also uncertain as to whether income from certain activities such as passenger cruises falls within the definition of transportation income. We believe it is appropriate to provide an allocation key for international shipping activities which reflects the extent to which this income is performed on the high seas.

Air transport and non-air transport freight charges for delivery of finished and component goods should not be treated as separate transactions from the sale of the good and sourced as transport services, even if the value of all Supplemental Transactions exceeds the 5% threshold currently required for the sourcing of combined transactions under the rules of the Main Transaction.

Revenues from financing

This source rule will likely need to be modified, probably substantially, if the Amount A exclusion for regulated financial services ends up being very narrow (e.g., for basic retail banking and life & property insurance). No information on these exclusions is available currently. In addition, source rules will be required to identify and clearly separate a bundled financial transaction, which involves both an excluded and a covered service. We anticipate this will be very problematic and laden with future controversy.

Revenues from business to consumer services

As an overarching comment equally to business to consumer and business to business services, we recommend that the rules for sourcing revenues rely on Value Added Tax (VAT) indicators whenever possible to improve the administrability of the rules and to benefit from tapping into existing, well-functioning systems familiar to taxpayers and tax administrations alike.

The Consumer definition in the rules still falls short. What happens if Consumers are pooled (and not located in the same Jurisdiction) and services are performed (outside of the Market Jurisdictions) by the Covered Group to various Consumer(s) pool (e.g., retirement plan services, even extended families)?

It is overly complicated how the rules distinguish between Consumers, non-Large Business Customers, and Large Business Customers. It may not be possible to discern whether a customer acquires a good or service for a personal purpose rather than for 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 if not 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, be readily available to a Covered Group, and may not provide consistent data across customers. Linking contracting parties to their Parent Company may not be possible (i.e., an affiliate in a jurisdiction may operate under a name unrelated to that of its parent), and in any event will be a time-consuming manual process. If the final Model Rules retain this approach, statistical sampling will need to be permitted, as discussed above.

The rules should not have any requirement related to obtaining customer headcount. Customer headcount information is not commercial and does not answer the question of where services are used any better than more commercial information such as VAT customer location indicators, for example. The contracting employee of the Business Customer may not have access to the relevant information or be able to disclose it. There may be valid business, competition, and legal reasons why the Business Customer does not want to share this type of information with the Covered Group.

This complexity validates the need to have certainty before Covered Groups, because of the rules, are required to create complex systems and processes for this data that is not consistent with commercial practice. Again, we urge the drafters to consider a transition period with more flexible data allowed or an elective allocation key decision that includes a comprehensive, timely and reliable process to get advance certainty on method before fully investing in the necessary systems to implement a compliant methodology.

Revenues from business-to-business services

In the context of Business to Business (B2B) services, including cloud computing services (including SaaS, PaaS, and IaaS models) and other digital services, MNEs cannot be expected to know and cannot determine the locations where their Large Business Customers' ("LBC") employees or customers use the services. Thus, as a general matter MNEs will not have any of the Reliable Indicators for sourcing B2B services of LBCs. This reinforces the need to have rules that would allow MNEs to support their sourcing determinations through a reasonable approach (including a Proxy Allocation Key), based on the MNE's particular facts and circumstances, that leverages *existing information and processes* and is not overly burdensome. Similarly, the application of alternative indicators or a Proxy Allocation Key should not be made dependent on establishing that the MNE asked their LBCs for this information and was denied.

The lack of data in these and other circumstances is not a temporary or transitional issue. Companies cannot simply change third party contracts to require information about where the customer or the customers' employees use the service. In many circumstances, the relevant data is proprietary information. Moreover, B2B customers are often also competitors of the B2B service provider. Consistent with the comments above, the collection and analysis of additional data for LBCs of B2B services would require additional time and resources to the extent that it is possible at all. The rules should take into account the commercial reality of the business to not require MNEs to make futile inquiries of thousands and thousands of customers.

For example, many B2B services are provided online and are fully automated. For these transactions, asking the customer to identify whether it is an LBC would be impossible as it would disrupt the commercial transaction. There is no engagement with anyone who could answer the question during the contracting process. An alternative and more administrable approach to consider would be to define "Large Business Customers" solely by reference to the size of the invoice, which is information that the MNE would have available to it.

Query why the billing address is a reliable indicator for Business to Business services for a customer other than Large Business Customer (LBC) but not for an LBC? LBCs may use numerous billing addresses, typically linked to the entity or unit consuming the service.

The threshold for using the billing address as reasonable for an LBC (EUR 1-3 million) is unreasonably low. In addition, it is likely impossible to determine aggregate billings to any specific LBC – as the sales data for different business units of a Covered Group may be siloed in different computer systems. In addition, a Covered Group may contract with various entities owned by an LBC, which may or may not share a common name or external indicator that they are part of an LBC. In theory, to implement this rule, it would be required to have a listing of all potential customer addresses used by each LBC (from that LBC), cross referencing that with invoice addresses for all invoices, aggregation of invoices to addresses belonging to each LBC, obtaining the non-public country by country reporting for each LBC customer annually, and sourcing aggregated LBC customer revenues according to that allocation key. Query how customers that change membership in LBCs during a tax year would be treated (as member/customer lists of LBCs could not be static given M&A activity, corporate restructurings, etc.).

Use of each individual customer's headcount as an allocation key is unreasonably complex – it would require customer-specific annual requests for non-public data unavailable to the filing group in a reasonable timeframe to permit compliance and would have no plausible linkage to the sourcing of services performed. (Most professional services, for example, would not be 'location-specific' services – or might be a mix of on-site and remote services. MNEs should be permitted, but not required, to break up mixed service into location-specific sourcing and then a generic LBC B2B sourcing allocation if they have the information available to do so.) Where an MNE is not permitted to use billing address as an indicator, it should be permitted to source revenue based on an allocation key without first asking LBCs for headcount data or other information. Consistent with the comments above:

- Customers are generally not going to provide this information willingly. Accordingly, asking for the information would not further the policy objective of accurately identifying the market jurisdiction in the majority of situations.
- Regardless of whether a minority of customers would provide this information, the time and expense associated with seeking and analyzing this information would be cost prohibitive and could not be justified based on the low expected yield of responses.
- If the final rules require MNEs to request information from their customers, it should only be required where the MNE expects a response and the process of seeking and analyzing responses would not be unduly burdensome, such as where the MNE has a limited number of LBCs and existing contracts allow it to require its LBCs to provide the requested information.

MNEs should be permitted to use their judgment as to whether a Reliable Indicator exists. If not, MNEs should be permitted to apply the Aggregate Headcount Allocation Key or an alternative Allocation Key that considers the information available to the MNE.

Business to Business Cloud Services

Covered Groups may have limited to no data available for the location where a customer uses B2B cloud services. To the extent that Covered Groups are required to establish the place of use for B2B cloud services, Covered Groups should be permitted to do so using access location data that is available in the ordinary course of business (e.g., data for the location where a customer accesses certain cloud service interfaces to prevent fraud or abuse (referred to as interface data)). This permitted data also includes any internal source of location or usage data that could be associated with the provision of cloud services. As in the case of advertising, the most detailed level of analysis should be at the customer level by legal entity, where a customer for sourcing purposes is defined as a customer for commercial purposes in a company's billing system. Additionally, there should be available to the Covered Group an elective safe harbor for any methodology that is valid for establishing the location of the customer for a specific tax compliance purpose other than for Amount A. To the extent that location data is not available using a methodology covered by the safe harbor, companies should be able to establish location using the billing address for which the margin for inaccuracy is very small.

Business to Business services sold through resellers

The rules should clarify that the scope of transactions that are treated as B2B services sold through resellers is limited to true back-to-back service transactions, not all B2B services where the customers use the service to provide services to their own customers. For example, it should be clear that the rules for B2B services sold through resellers do not apply to cloud services unless the reseller is reselling the same cloud service. An approach that focuses on the location of a cloud services customer's customers would be unworkable. MNEs are typically unable to obtain information regarding the location of these customers. Even if an MNE's business customer is itself required to collect information regarding the locations of its customers for purposes of complying with Amount A, they are unlikely to be willing to share that information with other businesses, which may also be their competitors. The same considerations apply to software as a service ("SaaS"), platform as a service ("PaaS"), and infrastructure as a service ("IaaS") models.

Headcount ignores the relative compensation differences that can be very pronounced (e.g., R&D v. tech/ service hubs v. front-office v. manufacturing functions). If headcount data is to be used, it should be limited to the aggregate headcount data collated by the OECD. However, there may be circumstances where an MNE has sufficient information available to allow it to develop an Allocation Key that would more closely approximate the Large Business Customer's use of a service other than headcount. In such circumstances, the final Model Rules should allow an MNE to use an alternative Allocation Key based on the information available to it. Any concerns regarding the reliability of an MNE's alternative Allocation Key could be addressed through the early certainty process.

Part 6 – Intangible property

Revenues from licensing, sale or other alienation of tangible property

Different jurisdictions characterize transactions involving intangibles and digital property in different ways (e.g., cloud services may be considered as a supply of an intangible by one jurisdiction and as a supply of a service in another jurisdiction). Without additional guidance on when different sets of rules apply, this lack of global consensus may result in disagreements as to which sourcing rules apply and what constitutes a Reliable Indicator.

Revenues from licensing, sale or other alienation of user data

The same issue applies as for revenues from licensing, sale or other alienation of intangible property, above. In addition, the characterization may be influenced by inconsistency in privacy laws between jurisdictions.

Part 10 – Definitions

Definition 9 "Jurisdiction" "Jurisdiction" means "a country or territory that is a jurisdiction for tax purposes." The structure of Amount A is at the national level, but this definition seems to extend nexus, sourcing, and allocations to the subnational level (states, cantons, provinces) and the supranational level

(EU). It seems appropriate to revise this definition so that it includes jurisdictions only at the national level.

Definition 10 "Knock-out Rule" The rule references a "reasonable assumption", while footnote 39 seems to require "actual knowledge." 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 is based on a reasonable assumption and does not require actual knowledge. 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.

Definition 11 "Main Transaction" Defining the Main Transaction as the 'primary profit-driver' of a multi-transaction bundle is not desirable in many ways. It requires significant incremental computations which may be competitively sensitive, difficult to audit, and not otherwise required for commercial reasons or financial accounting purposes (cost allocations, etc.). At least in part it is subjective, as many businesses consider profitability over a longer timeframe. For example, consider the sale of shaving razors and blades. The sale of a razor is necessary to generate revenue from the sale of razor blades. A single sale transaction for razor blades may be more profitable than the first sale of the razor. Because of this link, it may be considered in some part subjective and therefore will produce unnecessary controversy.

Definition 12 "Supplementary Transaction" The use of a maximum revenue threshold of 5% of the total transaction value for all Supplementary Transactions seems unreasonably low and likely to produce significant, unnecessary analysis of connected transactions as separate "Main Transactions" under the rules. Consider, for example the sale of equipment with a multi-year service plan and freight charge. Combined the freight charge and the service plan might easily exceed 5% of the value of a transaction.

Definition 14 "Digital goods" The treatment of certain online purchases (e.g., an in-app purchase in an online game) doesn't appear to have a clear home within the Rules. Possible treatment includes Digital Goods and general business-to-consumer services. Additional clarity would help – perhaps this is intended for the Commentary, but the OECD specifically requested areas that appear missing or incomplete.

Definition 49 "Reseller" How do the rules address situations where the Reseller adds some sort of value to the Consumer? For instance, financial services are oftentimes marketed and sold through multiple intermediaries. These rules will be infinitely impossible to sort through in such detail (and unduly complex in application).

Sincerely,

Timothy McDonald Chair, Taxation Committee United States Council for International Business (USCIB)	Rick Minor Vice President & International Tax Counsel United States Council for International Business (USCIB)

Appendix A

Elective Global Allocation Key Safe Harbor

Given the difficulties associated with applying the proposed nexus and sourcing rules, as well the potential for significant controversy concerning the application of the proposed "Reliable Indicator" rule, the members believe that it would also be appropriate to provide a simplified safe harbor on which Covered Groups could rely. Such a safe harbor would permit the Covered Groups to determine its Amount A allocations using generally available data that is accepted by the Inclusive Framework countries, such as the Global Allocation Key.

The total amount subject to allocation under Amount A (the Quantum referred to in the 8 October 2021 OECD statement) would be determined in accordance with the rules issued regarding the determination of tax base). The Lead Tax Administration would be responsible for confirming the Covered Group's computation of the Quantum.

The Covered Group would then apply the Knock-Out Rule to eliminate any jurisdictions where, as stated in the proposed draft, it can be reasonably assumed that Revenues did not arise. The Lead Tax Administration would also be responsible for evaluating the Covered Group's application of the Knock-Out Rule, subject to the general dispute resolution provisions adopted in connection with Pillar One. It should not be required, however, to apply the Knock-Out Rule on a transaction-by-transaction basis. If anything, it should be elective, or could be used where a company does not sell any products into a particular company. It will not be realistic to expect taxpayers to apply this Knock-Out Rule on a customer level or transaction level basis. It should not be required, however, to apply the Knock-Out Rule on a transaction-by-transaction basis. If anything, it should be elective, or could be used where a company does not sell any products into a particular country. It will not be realistic to expect taxpayers to apply this Knock-Out Rule on a customer-level basis.

The Amount A profits subject to reallocation to a particular jurisdiction would then be allocated to all remaining jurisdictions (i.e., those not eliminated under the Knock-Out Rule) using the Global Allocation Key. Alternatively, Covered Groups who demonstrate that they only provide goods or services in one or more regions could use appropriate Regional Allocation Keys (which would be expected, in the aggregate, to produce a result similar to the Global Allocation Key after application of the Knock-Out Rule. It may be more appropriate, in the case of business-to-business services, to base the applicable safe harbor allocation on the Aggregate Headcount Allocation Key, to the extent that headcount is a more reliable predictor of the benefit received by a particular business service recipient. Finally, for the avoidance of doubt, the jurisdictions receiving an allocation, irrespective of the method applied, should be permitted to impose tax on such allocated income at a rate no higher than the jurisdiction's highest rate generally applicable to businesses of a type similar to the Covered Group.

In all cases, we believe that the safe harbor should use generally available data that is otherwise used by the Pillar One nexus and sourcing rules as a basis for allocation. Much of the complexity for both Covered Groups and tax authorities that is discussed elsewhere in this letter arises from the difficulty of classifying transactions and obtaining data from commercial counterparties. We also note that certain portions of the proposed source and nexus rules appear to contemplate that country-by-country reports will be publicly available (see, e.g., the Headcount Allocation Key). Given that the publication of individual Covered Group's Country-by-Country reports is likely to be highly controversial and politically sensitive, we believe that safe harbors should rely on already-agreed apportionment bases.

The members acknowledge that a safe harbor that is based on the Global Allocation Key, or the Aggregate Headcount Allocation Key, will not in all cases closely align with a particular Covered Group's business activities. However, in aggregate we believe that it is likely to dramatically reduce the compliance complexity associated with Pillar One without significantly changing the overall income allocation across jurisdictions, since the data used for the Global Allocation Key is intended to reflect general levels of economic activity. Covered Groups that can demonstrate a more Reliable Indicator—and wish to expose themselves to tax authority audit on such Reliable Indicator—would be free to do so.

Appendix B

Elective Covered Group Market Characteristics

A more effective way to allocate Amount A would be to look to the allocation methodology under the Authorized OECD Approach ("AOA") and the use of Significant People Functions (SPFs) or Key Entrepreneurial Risk Taking functions (KERT) in order to allocate profit and loss. Amount A can be allocated based on the analysis of relative value of a market to an enterprise. The rules can use Key Market Characteristics ("KMCs") to determine the portion of Amount A each nexus jurisdiction should receive. KMCs can potentially be determined using some combination of the following: 1) sales, 2) advertising dedicated to market, 3) GDP, 4) population, and/or 5) other reliable indicators.

Using this or a similar method will eliminate or reduce many of the criticisms enumerated by the members. It mitigates the need for some of the more detailed information described above. The information/documentation to determine KMCs is more readily available than to information/documentation required to be tracked on a transaction-by-transaction basis and will not require new systems. The allocation of Amount A would be specific to each taxpayer and thus meet the goals of Draft Model Rules for Nexus and Sourcing. It is far more auditable and tax authorities will not have to exhaust as many resources to audit an enterprise's stated KMCs and allocation methodology. Lastly, as with the AOA, it will provide a much more reasonable result that lends itself to resolution of double tax via competent authority.

Appendix C

Elective Simplified Finished Goods Revenue Sourcing Approach

The OECD/ Inclusive Framework (IF) has committed to a reallocation of a portion of an in scope MNE's residual "excess return" to each destination sale market where sales into that market meet or exceed the agreed sales threshold levels. The proposed detailed approach for revenue sourcing is currently based upon a transaction-by-transaction premise. For most businesses, complete precision is either impossible or highly impractical and costly, so estimates are inherently necessary. The suggested simplified approach in contrast to the current proposal can be administratively highly efficient and will provide full tax certainty as it relates to revenue sourcing while meeting this same broad reallocation of taxing rights objective of Pillar One.

<u>Administrative efficiency</u>: The rules create potential dramatic inefficiency and administrative burden concerns. Efficiency in this respect can be measured as the cost to achieve administrative compliance as compared to the revenue collected. To illustrate, assume a MNE has a 20% operating profit and the minimum sales threshold under Amount A in a jurisdiction with a 30% corporate tax rate. A 20% operating profit will generate a 2.5% of sales "excess return" for Amount A. As the agreed nexus sales thresholds of EUR 1 million and EUR 250 thousand respectively for large and smaller jurisdictions, the amount of tax the jurisdiction receives at the sales nexus minimum is EUR 7,500 or EUR 1,875 of tax, respectively.

To the best of our knowledge, outside of specific regulated industries, IT systems do not capture all the information necessary to implement a reliable transaction by transaction destination sales revenue sourcing. It would be typical for a finished goods sale between a MNE within scope and its third-party wholesaler or distributor to have on a single invoice with between 100- or 1,000-line items describing specific products, sizes and bundling. The proposed approach theoretically anticipates tracing to an ultimate jurisdiction of consumption not only each line item but also portions of each line item. The business community is concerned that some jurisdictions may want to attempt this level of precision irrespective of the implicit cost to comply. We would also anticipate the one-time IT systems modifications necessary to capture this destination sales information will be substantial (multiple EUR millions) if such precision were attempted. Furthermore, under the rules, the ongoing annual administrative cost to comply for each jurisdiction will likely exceed many, perhaps hundreds, of multiples of the annual tax allocated to each jurisdiction at the minimum sales threshold where the MNE currently does not generally have a taxable nexus but will have an Amount A allocation.

<u>Tax Certainty</u>: The many references in the rules to a reliability standard raises concern that a qualitative and subjective standard will invite alternative interpretations from various tax authorities with the potential that genuine good faith efforts by the MNE will be interpreted as non-compliant. This situation will increase the incidents of double taxation, potential penalty risk, and reputation risk. An objective formulaic approach creates substantially greater tax certainty than the proposed transaction-by-transaction approach.

Precise revenue sourcing creates three types of challenges for finished goods transactions. The first and primary challenge is determining revenue sourcing where the MNE has no current taxable presence in a jurisdiction and sells to a third party who distributes the finished goods possibly in multiple market jurisdictions. Typically, the MNE will not know and may be legally prohibited from precluding re-exportation by the third party to a third selling jurisdiction. The second challenge relates to sales by the MNE into a jurisdiction where the MNE is taxable but the third-party wholesaler or retailer may divert the sale to an additional market. Legal and commercial constraints may limit the ability to allow the MNE to inquire or control this type of diversion/re-exportation. In the final type of transaction, a variant of the second challenge, the MNE sells in a market where it is generally taxable to the retailer or wholesaler who in turn sells in that market to a third-party (potentially even to an individual at retail) and that customer/individual exports/diverts the goods to an alternative market where the goods are consumed. There is no practical way for the MNE to track this information.

A Simplified Alternative: To meet the Pillar One objective of allocating revenue to market jurisdictions while minimizing the above expressed concern of a transaction-by-transaction approach, we suggest using a proxy which allocates and apportions sales to jurisdictions where the MNE does not have a traditional corporate income tax taxable presence based on objective criteria.

Step one, "Sales to Markets where the MNE does not have a taxable presence": The MNE would determine what proportion of its global sales it directly exports from a jurisdiction where it is taxable to all jurisdictions where the MNE is not taxable under current income tax principles and treaties. These sales are placed into a pool and combined with an OECD safe harbor deemed reexported sales. The deemed exported concept addresses the potential that the MNE's direct third-party sale and/or succeeding third-parties' sales (including even individuals) may divert a sale from the jurisdiction where the MNE shipped the finished goods to one or more additional jurisdictions. These sales create a pool of sales to be re-allocated.

Step Two, "allocation of export and deemed export sales": The direct export and deemed reexported sales and associated tax revenue identified under such an approach would form a global pool of sales to be shared with IF jurisdictions where the MNE has no current taxable presence. The allocation to IF countries where the MNE has no taxable presence based on the jurisdiction's share of GDP or official national consumption data relative to all IF jurisdictions where the MNE has no taxable presence. For most MNE's that sell finished goods, the MNE typically establishes a taxable presence in a jurisdiction to secure greater control of its business once the sales in that market approximate the break-even profitability level to support the incremental cost of establishing and running the additional subsidiary in that new expanded jurisdiction. As a result, MNE's typically have over 95% of their finished good sales sold to a third party and delivered into that same jurisdiction where the MNE has a taxable presence. This non-tax economic reality can provide a reference point for ensuring that the proposed safe harbor sales reallocation does not over or under allocate to jurisdictions where the MNE does not have a taxable presence. It is reasonable to assume that countries where the MNE has not established are not generally larger than those where the MNE has a taxable presence.

Reallocation maximum and minimum: To ensure that the allocation described above is not excessive or underproportioned, we further suggest that the allocation has a maximum cap of 125% of the average of the MNE's sales in the smallest ten jurisdictions where the MNE has a taxable presence. The cap is higher than the described average as these jurisdictions do not receive a distributor's return from the MNE. For the typical MNE the cap for finished goods revenue sourcing will be applicable because the overwhelming proportion of their sales are in taxable jurisdictions. We also propose a minimum allocation under this formulaic approach which is 75% of the average sales of the smallest ten jurisdictions where the MNE has a taxable presence.

The diverted sales dilemma: The step one export calculation described above will likely account for a vast majority or possibly all the destination of consumption sales for most finished goods transactions of a MNE. It is clear however that some IF member countries have concern regarding so-called diverted reexported sales. The second part of step one anticipates addressing this need.

We considered the diverted sales challenge and we identified two possible indicia that would suggest the possibility that a diversion is more likely and have suggested an approach for what we believe is the more reliable indicia. The first indicium looks at what percentage of a MNE's sales are in jurisdictions where it maintains a taxable presence. The higher the direct export sales percentage in step one, the more likely that sale are diverted to markets beyond the ship to destination. Unfortunately, many factors could cause this fact pattern and we could not think of a highly reliable reallocation factor to account for this potential diversion. We believe a second factor has more promise to be reliable, i.e., the relationship between a finished goods gross margin to post-production (finished goods) transportation and warehousing costs. The larger the finished good's post-production logistics costs relative to the transactions gross margin the less likely the finish good will be diverted from the last known shipment jurisdiction. A competitive reality is that where logistic costs are high relative to a product's gross margin, re-exporting goods to other markets becomes uncompetitive particularly where competitors make competing goods in or closer to the same market. The inverse is also generally true, high gross margin low logistics costs finished good transactions are more capable of re-exportation or diversion.

To illustrate the OECD/IF could adopt a sliding scale "deemed re-exportation" percentage could look something like:

Logistics costs relative to GM%	Deemed re-exportation %
Greater than 10%	0.20%
10% to 7.5%	0.40%
7.5% to 5%	0.60%
5% to 2,5%	0.80%
Below 2.5%	1.0%

To significantly improve the administrability of the above proposed approach, it should utilize financial information with a one-year lag so that taxes can be accurately accrued during the year (year one data is used to calculate the amount A for each jurisdiction for year two).

Illustrative Example. Assume the MNE has EUR 20 billion in sales, its post-production transportation and warehousing costs to gross margin ration is 11%, it ships 98% of its worldwide sales to third parties in jurisdictions where it has a taxable presence, there are 20 IF countries and 60 non-IF countries where the MNE does not have a traditional taxable presence, and that its average sales in the ten smallest jurisdictions where it has a taxable presence is EUR 15 million.

Step One:

Direct export sales	400 million (2% of 20 billion worldwide sales)
Deemed re=exported sales	39.2 million [(20 billion – 400 million) x .002]
Total sales allocated	439.2 million

<u>Step Two:</u>

Initial allocation to 20 IF countries	21.96 million (439.2 / 20 countries)
Limitation (125% ave.10 smallest taxable)	18.750 million (15 million x 125%)

Alternatively, if the MNE had the same facts as above but there were 40 IF jurisdictions where the MNE did not have a taxable presence, the guaranteed minimum would apply. 75% of 15 million sales for the MNE's smallest 10 taxable jurisdictions = 11.25 million and that is greater than the share Direct exports and deemed reexport sales to each of the 40 non-taxable IF jurisdiction of 10.98 million (439.2 million/ 40 countries).