Response to Consultation on the Pillar One Blueprints

(December 2020)

This response is provided by a working group of the Centre for Commercial Law (CCL) at the University of Aberdeen. The working group consists of Dr Qiang Cai and Mr Chike Emedosi, and the response incorporates comments by Dr Burcu Yüksel Ripley.

I. The activity test to define the scope of Amount A. Comments are invited on the design and implementation of the proposed activity test relating to Automated Digital Services and Consumer-Facing Businesses, including any challenges and suggestions on how to address them? [Refers to paragraphs 38-170 of the Blueprint]

Re. paras 57 – 74 (Pharmaceuticals): We suggest that all drugs used by patients/consumers should be included in the scope of Amount A, not least for the purpose of equitable distribution of tax revenues and simplicity of tax administration. It is important to stress that healthcare in most developing countries, and even in some developed countries, is highly privatized and has little or no government funding. This means that even where some drugs are categorized as "prescription drugs", pharmaceutical companies sell them at full price to private healthcare providers, which, in turn, trickles down to final consumers. According to a study, some 201 essential medicines were unaffordable in nearly all low-income countries and 13 middle-income countries.[1] This buttresses the fact that there is almost a zero government subsidy on essential drugs that are normally prescribed to consumers in developing countries and the government subsidy argument does not apply in these cases.

Big pharmaceutical manufacturers can also make huge profits from sales of prescription drugs in jurisdictions with advanced public healthcare. They have been found to make

[1] Hill AM, Barber MJ and Gotham D, "Estimated costs of production and potential prices for the WHO Essential Medicines List" BMJ Glob Health (2018) 1.

significant profits from the sale of essential medicines in advanced economies like the UK.[2] For example, it has been reported in an OXFAM study that a standard 12-week course of Paclitaxel, which can be produced at USD 1.16, sells for USD 276 in the US and USD 912 in the UK.[3]

Furthermore, we think that it may be counter-productive to afford these big pharmaceutical manufacturers that have been found to engage in tax dodging and price gouging activities an exception based on prescription drugs. That will be helping their course. The OXFAM study found that four major pharmaceutical firms reported annual global profits of up to 30 percent and stashed about USD 4 billion in overseas tax havens, thereby depriving governments (especially the developing ones) of much needed tax revenues.[4]

Re. para. 87 (licensing): We take the view that for a licensor to be qualified as conducting CFB, there is no need for the licensor to "supply (or has in the past supplied) a consumer-facing good or service". For example, the franchiser of the KFC does not necessarily operate the KFC restaurants by itself.

A related suggestion is that a licensor would still qualify as CFB even if the activities of the licensee concern ADS.

Re. paras 93-104 (dual use products): We suggest that the Blueprint should not take different approaches between dual use finished goods/services and dual use intermediate products/components. First, if it is difficult to track revenue for dual use finished goods, the same difficulty should also plague dual use intermediate products. Second, attention should be paid to borderline cases between finished goods and intermediate goods, such as various types of tools or toolkits. Third, the different approaches may lead to distortion. For example, MNEs may elect to sell components to business clients who then assemble the components

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[2] ibid.

[3] OXFAM, "Prescription for poverty" (September 2018), https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620548/cr-prescription-for-poverty-180918-en.pdf, 44.

[4] ibid.

into finished products.

We suggest that for both types of products, consumer-facing sales should be, and can be, isolated from business-facing sales. A simple way to do so, albeit less precise, is to treat all VAT sales as business sales.

Re. paras 109-121 (natural resources): We think that even resources products may be caught by the CFB provided that they are sold to final consumers in their brand-names. Para. 117 (and elsewhere) states that "…to a consumer, even if sometimes these products are sold under a brand name, there is generally little that distinguishes one MNE's product from another's". However, if an MNE supplying such products can acquire substantial market share in a market jurisdiction and hence meet the revenue threshold even though the product itself is generic, then it would be natural to assume that the company has engaged in considerable marketing and branding efforts in the market jurisdiction. Therefore, it seems more compelling to apply Amount A to the MNE. Conversely, if no significant consumer engagement is involved, MNEs should not be able to meet the revenue threshold due to the generic character of the products.

Attention should also be paid to the increasing efforts by MNEs to brand and market their resources products, such as coffee beans, mining water, and other niche agricultural or horticultural products.[5]

General comments on Topic I:

We take the view that the identification of CFB should mainly hinge upon the nature of the transaction (i.e. whether B2B or B2C) rather than the nature of the goods/services. This is because first, CFB itself is a business characteristic rather than physical quality, and voluminous disputes may arise from those borderline cases. Second, if products are sold to final consumers through full-fledged enterprises (either distributors in the case of finished products or downstream manufacturers in the case of intermediate components) located in

[5] B. Walsh, Marketing Agricultural Products and Services, 56 (Tocal College, NSW DPI 2015).

market jurisdictions, these market jurisdictions may have already satisfied their fiscal interests by taxing their resident enterprises. Indeed, in discussing the treatment of financial services, the Blueprint also considers the nature of transaction and its impact on the fiscal interest of the market jurisdiction. We suggest that this approach should be extended to all other types of products/services in order to ensure consistency.

There is a particular question which has not been articulated in the Blueprint: consider A co, which is an OEM in Country R, sells finished mobile-phone to B co, which is resident in Country S. B co then sells the phones to local consumers under its own name. If based on the inherent character of the products, it seems even OEMs also qualify as supplying CFB since the products are finished and designed for final consumption. However, based on the spirit of the Blueprint, all OEMs should be excluded from Amount A irrespective of the character of the products they produce.

II. The design of a specific Amount A revenue threshold (in addition to a global revenue threshold) to exclude large MNEs that have a *de minimis* amount of foreign source in-scope revenue. More specifically, comments are invited on what would be the best approach to define and identify the domestic or home market of an MNE group (e.g., the residence of the ultimate parent entity). [Refers to paragraphs 182-184 of the Blueprint]

We suggest adopting the approach of ultimate parent entity. Attention should be paid to a scenario where an MNE deploys low-risk distributors in all relevant market jurisdictions, and those distributors are all registered as local residence. In that case, all revenue would be domestic revenue.

III. The development of a nexus rule.

Re. plus factors: For CFB, we would suggest the additional revenue be a deemed nexus. This is not only for administrative simplicity, but also because the aim of Pillar 1 is to address the problem of "scale without mass". Particularly in the case of sales through independent distributor, it is possible that an MNE can carry out large scale business in a market jurisdiction without deploying any presence of its own therein. Even in cases where the MNE does send a number of personnel to visit the market jurisdictions, it would be difficult for the tax administration of the host country to detect the presence of those personnel.

Re. temporal requirement: We suggest not having this requirement, as it is susceptible to manipulation. However, a taxpayer is entitled to contend that the above-threshold revenue of certain year results from a one-off transaction or some external factors rather than continuous consumer engagement. The rebuttal can be further substantiated by the fact that the revenue of other years was significantly lower than the threshold.

IV. The development of revenue sourcing rules.

Re. paras 250-255 (commission fee of intermediation platform): For intermediation of tangible goods, we take the view that revenue should not be sourced to the place of seller. This is because first, the success of market platform mainly results from purchasers. Second, the relationship between the platform and sellers are business-facing. A related argument is that the number of sellers is generally far smaller than that of purchasers, and therefore, the platform will have far less engagement in sellers' jurisdictions. Third, in the case of social media platform, the revenue from advertising is sourced to users' places. A consistent approach should be adopted for all double-sided marketplaces.

Re. para. 374 (Revenue sourcing rules regarding CFB through independent distributor): A notable difficulty arises where an independent distributor further contracts with other distributors (particularly those in different countries) to distribute the commodities. The *Secretariat Proposal for a 'Unified Approach'* (October 2019) suggests that only sales through routine distributors will be included in CFB. We believe that this position can address the sourcing problem well because routine distributors are typically local retailers in market jurisdictions. That suggestion also corresponds to the principle we have articulated above, i.e. what matters here is not the physical character of the goods/services, but the nature of the transactions. If an independent distributor further contracts with other distributors, this former enterprise generally would have engaged in significant entrepreneurial activities and therefore remunerated decently. Indeed, such distributor may play a dominant role in the supply chain vis-à-vis the supplier. This further means that the market jurisdiction can well satisfy its fiscal interests by taxing this grant distributor rather than reaching to the non-resident supplier.

IX. The issue of scope of Amount B and definition of baseline marketing and distribution activities.

We do not support the exclusion of less-than-baseline activities from the scope of Amount B, since one of the major challenges of digitalisation is that information and communication technologies have enabled MNEs to minimise their oversea presence. For example, if an MNE deploys a delivery branch in a market jurisdiction for the purpose of contract fulfilment, traditional ALP may not be helpful for the market jurisdiction since the delivery function would be too auxiliary to constitute a permanent establishment.

We understand that if this delivery branch is included in the scope of Amount B, there would be a problem of attributing the quantum of Amount B to the branch since the sales revenue can hardly be attributed to a delivery function directly. In this connection, we would suggest using the method of cost-based return (the specific ratio can be based on the cost-based TNMM) to compute the quantum. Indeed, this cost-based return can be extended to baseline activities that are typified in Amount B. Accordingly, if the ALP method has already been allocated to the physical presence profits that exceed the quantum based on cost-based TNMM, then Amount B will not apply (safe harbour mechanism).