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What’s the Outlook on Tax Certainty for MNEs Subject to Amount A?

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The promise of certainty in tax matters, a key element of the October 2021 agreement of the OECD-led Inclusive Framework on BEPS, may be the most ambitious part of the plan. Jeff VanderWolk of Squire Patton Boggs discusses the drivers behind the OECD’s proposals for tax certainty, as well as the risks ahead.

Readers who follow international tax developments will be familiar with the political dynamic that led to last year’s unprecedented agreement among 137 countries on the so-called two-pillar solution regarding taxation of business profits of multinational enterprises (MNEs). Numerous countries’ piecemeal adoption of digital services taxes and other unilateral tax measures aimed at nonresident MNEs provoked retaliatory action by the US in the form of tariffs, or the threat of tariffs, on a wide range of exports to the US from those countries.

There was also a growing belief—encouraged by public comments of some government officials and OECD tax policy officials—that the transfer pricing guidelines followed in most countries were ineffective in preventing MNEs from shifting profits to low-tax jurisdictions, and were incapable of producing clear outcomes, leading to disputes regarding the allocation of MNEs’ profits between different jurisdictions.

The proliferation of inconsistent unilateral measures leading to trade retaliation on one hand, and the perceived problem of MNE profit allocation under the existing transfer pricing rules on the other, appeared to constitute a threat of chaos in international taxation that could not be ignored. To address this perceived threat, the 140-member Inclusive Framework on BEPS, led by the OECD and strongly influenced by the Biden administration’s Treasury Department, adopted the two-pillar solution in October 2021. A core piece of the plan was global agreement on a formula by which “excess profits” of very large and profitable MNEs (so-called covered groups) would be allocated among the various countries where the MNEs’ customers were located. The amount allocated to a country under the formula was dubbed Amount A.

It was recognized that using the Amount A formula for any given covered group would involve a massive effort to harmonize certain income tax rules to be applied in many different countries and could result in significant headaches for both taxpayers and tax authorities in the form of new compliance burdens and administrative costs. It would also create a risk of multiple taxation of the same "excess profits" being allocated under the formula if different countries interpreted the new rules differently.

Therefore, the Inclusive Framework included in the plan a commitment to create "dispute prevention and resolution mechanisms" to provide tax certainty regarding Amount A allocations "in a mandatory and binding manner." Assuming it could become a reality, this tax certainty benefit is one of two "carrots" offered to the MNE community in the two-pillar plan. The other is the elimination of all relevant unilateral measures such as digital services taxes.

On May 27, 2022, the OECD issued two public consultation documents. One had proposals regarding multilateral tax certainty in determining Amount A allocations. The other had proposals regarding bilateral dispute resolution involving "issues related to Amount A," which were said to include transfer pricing disputes and disputes over the allocation of business profits to a permanent establishment, and perhaps other, unspecified types of disputes.

The proposals for a globally consistent application of the Amount A formula involve three different types of review panels: one for scope certainty as to whether an MNE is within the scope of the Amount A rules; another for advance certainty as to the proper approach to applying the rules for one or more future taxable years; and a third for comprehensive certainty as to the Amount A allocations for a taxable year that has already ended. If a review panel cannot reach an agreement, the MNE's case is referred to a determination panel that has the authority to make a decision that is binding for all countries involved. The proposals on dispute resolution for transfer pricing, PE profit allocation, and (possibly) other issues related to Amount A also include determination panels that can impose a binding decision on the countries involved.

Who will sit on these panels? The consultation documents say that this is still being discussed among the Inclusive Framework members. Perhaps independent international tax experts will be used; perhaps not. How will decisions of the panels be enforced? This also is unclear, which is not surprising since the Inclusive Framework is composed of sovereign nations that reserve the right to apply their national tax laws as they see fit.

There is very little history of mandatory binding dispute resolution between countries in tax matters. There is no history at all of adjudication of the competing tax claims of three or more countries regarding the taxation of an MNE's business profits. In a different field of law related to cross-border activities—namely, trade regulation—we can consider the experience of the World Trade Organization, which established a dispute settlement process at the time of its creation in 1994, with review panels and an appellate body empowered to make binding decisions in the event of disagreement.

According to a recent article from the International Institute for Sustainable Development, the WTO appeals mechanism "is not functioning because the United States blocked appointments to the Appellate Body, which has led to most panel reports being appealed 'into the void' and leaving the dispute unresolved." Even before the Trump administration shut the process down, the Obama administration indicated its unhappiness with the process.

The 164-member WTO held its first global meeting since 2017 on June 12-15 in Geneva. Unsurprisingly, the member countries were unable to agree on how to reform the dispute settlement system. They did, however, agree to talk about it further.

Perhaps it simply is not realistic to think that independent nation-states will ever cede any degree of sovereign power over their ability to regulate trade with other nations—or their power to tax nonresident businesses with customers in their country as they see fit. The Inclusive Framework on BEPS will need to develop its tax certainty proposals regarding Amount A quite a bit further, keeping the WTO's experience in mind.

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