Thursday, 27th August

Assessing the 1920s Compromise

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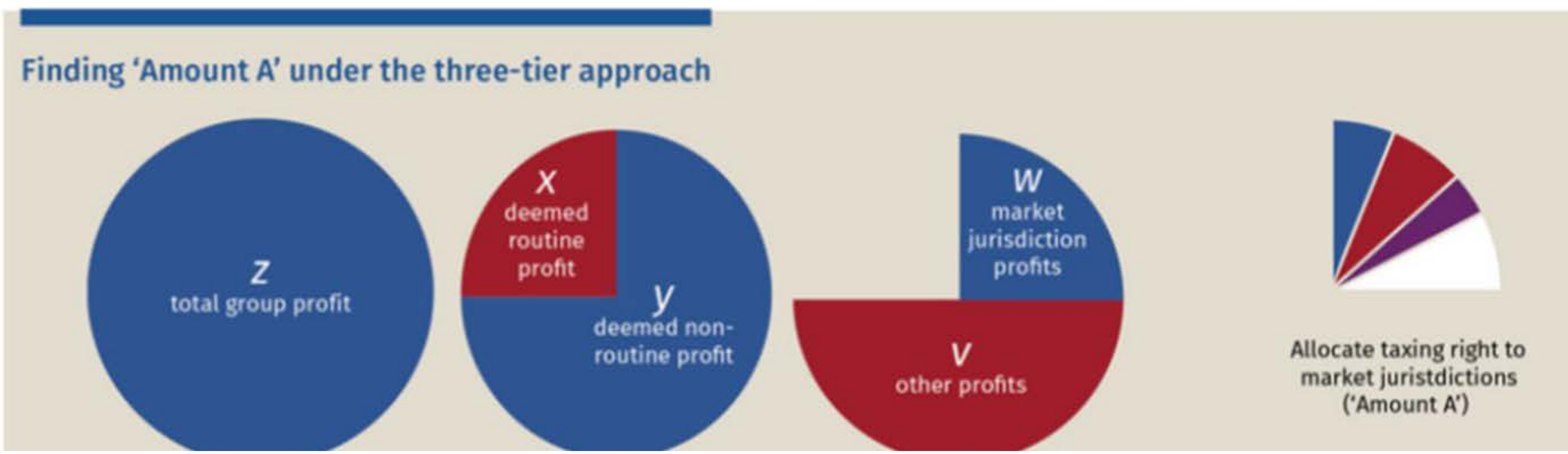
NEW ZEALAND

AUCKLAND LAW SCHOOL

4 Steps (or 3 tiers)

- Identify the MNE's profits
- Separate out profits attributable to routine functions
- Attribute a portion of the non-routine (residual) profits to the market jurisdiction
- Allocate the deemed residual income to eligible market jurisdictions



Assessing the 2020s compromise

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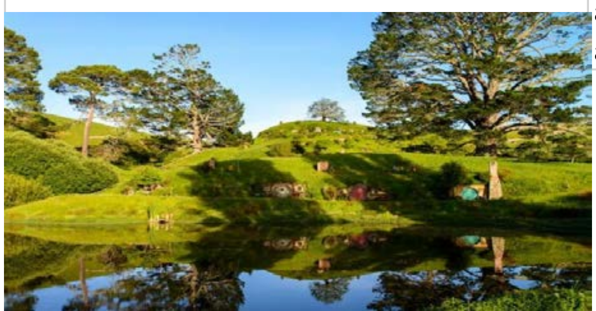
Seven Challenges to 1920s Cimpromise	Pillar One (Amount A) Non-arm's length principle?	Pillar One (Amount B) Arm's-length principle	Pillar Two (income inclusion rule)	Pillar Two (base erosion payments)
(1) The vanishing ability to tax business profits				
(1A) Nexus	Digital business no requirement for PE			
(1B) Allocating income	1920s compromised allocated profits to factors of production (residence-based) but the 2020s compromise allocates profits to the marketplace	Under the modified residual profit split method a fixed remuneration for baseline marketing and distribution functions is attributed to the marketplace		
(2) The use of data, the contribution of users and the measurement of their value	A component of income allocated to the market jurisdiction for the use, creation and valuation of data			
(3) The reliance on, and mobility of, intellectual property			If intellectual property is located in a low tax jurisdiction	Royalties paid for the use of intellectual property might be subject to the undertaxed payments rule or the switchover rule

Assessing the 2020s compromise

(4) The characterisation of transactions and income	Income characterised as business profits could be included in Amount A overcoming the nexus requirements		Income diverted to a low tax jurisdiction can be subject to the IRR	Transactions characterised as deductible payments would be caught by the UPR or SR
(5) The failure of transfer pricing with certain MNEs and their transactions	The profit allocation rules Ignore the single entity concept of allocating profit on a modified residual profit split basis	Amount B provides a fixed remuneration for baseline marketing and distribution functions in the market jurisdiction	The IIR overcomes the risk of transfer pricing profits to low tax jurisdictions	By denying deductions or imposing a withholding tax the use of arm's-length transfer pricing techniques to shift profits is reduced
(6) The inadequacy of residence-based taxation			The IIR are reduces the incentive to incorporate an entity in a low tax jurisdiction	Denying deductions or imposing withholding taxes on profits shifted to entities in low tax jurisdictions
(7) Competition by States	Through one lens tax competition through highly digitalised entities has enabled a huge competitive advantage that Amount A addresses in a small way		The IIR is designed to eliminate the advantages of incorporation in a low tax jurisdiction	The undertaxed payments rules also address profit shifting



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