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Submitted by email: cfa@oecd.org

December 14, 2020

Ref: OECD/G20 Inclusive Framework on BEPS – Reports on Pillar One and Pillar Two Blueprints

Dear Secretariat Team,

Thank you for the opportunity to comment on the Reports on the Pillar One and Pillar Two Blueprints. As we have communicated throughout the course of the digitalizing economy project, this work will fundamentally reshape the international tax rules, and we are grateful that stakeholder engagement continues to be sought. We also salute the remarkable work you have done pulling together the Blueprints, and endeavoring to reconcile divergent views among the 137 members of the Inclusive Framework over a vast range of topics. It has been a Herculean effort.

As we have at other points in this project, we have tried to measure the Blueprints against our *Business Principles for Addressing the Tax Challenges of the Digitalizing Economy*, which we continue to believe are helpful and important benchmarks. In the case of divergences between the Blueprints and those principles, however, rather than simply noting that and moving on, we have tried to make constructive suggestions to close those gaps. We remain committed to the OECD process, and will be indefatigable in our defense of multilateralism.

The attached letter focuses, appropriately, on the details of the Blueprints (although providing input under thematic headings, rather than according to the strict order of the questions posed in the consultation documents). But this project is of such vast scope, and with such differing impacts across sectors, that businesses have had difficulties coming to a single view – particularly where, as in some cases, the animating principle of a provision is unclear. Thus, in our letter, we must respect the differing positions of our members, and often present alternatives. Nevertheless, we still hope that these comments will be helpful in informing the ongoing work of the Inclusive Framework to improve and streamline many of the Pillar One and Pillar Two provisions.

However, in the same way that there are disagreements within the business community, there are also significant disagreements between governments which pose challenges to the project. This is completely understandable when there are so many divergent interests between wealthy and less wealthy economies, small and large markets, export and non-export-oriented countries. But, time is now running short to reach agreement before other regional organizations and countries begin to move unilaterally. We hope, therefore, that despite the broad ambition of the Blueprints, consideration may be given to reaching a more limited agreement by June 2021, coupled with a binding undertaking to engage in a more fundamental medium- to long-term discussion.

In relation to this last point, proxy battles have been fought both during BEPS and now during this project over the fundamental issue of source vs. residence (and now market vs. residence). Rather than have this sparring continue indefinitely, it might be better to put those issues squarely on the table and see if a new international consensus can be reached which could restore stability to the international tax system.

Again, we thank you for the opportunity to comment on the Blueprints, and look forward to further engagement at the public consultation meeting and beyond.

Sincerely,

Will Morris

Will Morris
Chair, Taxation and Fiscal Policy Committee,
Business at OECD (BIAC)

Business at OECD (BIAC) Written Response to the OECD Public Consultation on the OECD/G20 Inclusive Framework on BEPS
Reports on the Pillar One and Pillar Two Blueprints

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Business at OECD (BIAC) Written Response to the OECD Public Consultation on the OECD/G20 Inclusive Framework on BEPS Reports on the Pillar One and Pillar Two Blueprints

Executive Summary

1. *Business at OECD* appreciates the opportunity to provide feedback on the OECD/G20 Inclusive Framework's Pillar One Blueprint and Pillar Two Blueprint. **As the voice of business at the OECD, we aim for our comments to be constructive, both in supporting and challenging elements of the proposal where our members express strong unanimity, as well as in highlighting differences of opinion on the challenges where views diverge**.

2. The recently published Blueprints contain numerous technical developments for Pillars One and Two in the continued search for a consensus-based solution to aspects of the international tax system that result in outcomes that not all countries consider appropriate in a globalized and digitalized economy. **We applaud the significant work undertaken by the Secretariat, Inclusive Framework members, and technical working groups over these past months**.

3. **We again stress the need for both Pillars to be rooted in widely accepted principles in order to achieve both long-term sustainability as well as consistent interpretation**.

4. **Unilateral measures** seeking to deal with these challenges are causing uncertainty and investment caution, and **must be definitively removed by all participating countries** with a commitment to forego future measures at odds with the purpose of any reached agreement to provide a new system of taxing rights. As part of the ongoing commitment, the Inclusive Framework should agree upfront to an initial list of unilateral measures by country that would need to be repealed upon reaching a global agreement.

5. On 21 January 2019, *Business at OECD* published Business Principles for Addressing the Tax Challenges of the Digitalizing Economy ("Business Principles"). This list of 11 policy recommendations should, we urge, continue to be considered in developing modifications to the underlying international taxation norms for the modern digitalizing economy. The core principles outlined in the Ottawa Taxation Framework (which are referenced in our Business Principles) should also continue to be adhered to in this process.

6. Reform of the international tax rules is needed, but should be focused and proportionate. Successful implementation is critical. The Inclusive Framework could **consider adopting a phased approach to aspects of Pillar One** before a full rollout to all in-scope taxpayers. This would limit the initial learning curve challenges to those companies most able to bear the compliance burden, maximize opportunities to make adjustments where necessary, and give time for all stakeholders to be educated on the new rules. If pursued, this phased approach should not discriminate against any particular industry or country in scope of the new rules, as confirmed by an economic impact analysis of such an approach.

7. *Business at OECD* strongly emphasizes the **need for clarity and simplicity** in every aspect of the Pillar One and Pillar Two frameworks. The contemplated rules represent significant departures from the existing international tax system, involve a high degree of complexity, and consequently will subject both taxpayers and governments to substantial costs for compliance and administration. Therefore, finding opportunities for simplification must be a driving focus going forward. In our technical comments below, we offer several suggestions in support of that goal.

8. A long-term issue that applies across many elements of the Blueprints, is that there must be a clear, committed process for updating definitions (such as those underlying the "activity test") in order to maintain consistent interpretation among countries subscribing to Pillar One. Otherwise, without an orderly schedule of review, jurisdictions will be tempted to unilateral updating of terms that will create detrimental divergences (giving rise to administrative complexity, increased controversies, etc.).

9. There is no question that **business supports developing early tax certainty processes** to prevent and resolve disputes arising from Amount A. One of the key challenges in providing early certainty is **determining which MNEs are low-risk** and thus able to be filtered out to minimize the number of audits and tax adjustments being made by governments. We suggest further consideration of the notion reflected in para. 746 of the Blueprint that Amount A could be implemented on a phased-in basis as to allow tax authorities and taxpayers to gradually adapt to the new rules in a manner that will avoid confusion and being overwhelmed. As noted above, this phased approach should not discriminate against any particular industry or country, as confirmed by an economic impact analysis of such an approach.

10. It is important to restate that much of the anticipated uncertainty from Pillar One arises because **Amount A does not rest on longstanding principles**. For decades, tax administrations and businesses have relied on the arm's length principle as the universal basis for allocating taxable profits among countries; this has been extensively accepted by OECD members and other jurisdictions, supported by the OECD Transfer Pricing Guidelines and the UN model treaty. Because Pillar One introduces new formulaic methods for allocating profits, an exhaustive new set of detailed rules will need to be created to prescribe the calculation and scope of these new measures. This, of course, creates a bit of a catch-22 in that there is necessity for a clear articulation of the steps needed to apply, verify, and audit the calculation and allocation of Amounts A and B, while at the same time not create enormous complexity. We recognize the tightrope that exists between these two end points, and encourage the Inclusive Framework to opt for simple, administrable rules wherever possible.

11. These rules will need to be adopted by each participating country through introduction into their domestic law. Similar to what the EU has done in the context of VAT (through the use of a directive and individual member state transposition), it seems the Blueprint envisions working groups at OECD to draft all the rules that will be needed to define the detail of the scope and calculation of the new measures and to produce a mechanism to provide early certainty and deal with disputes, and provide the mechanism for these rules to be embedded in domestic law systems. We encourage the Inclusive Framework **to instill specificity into implementation guidelines and governance documents to ensure uniformity** of Pillar One across Inclusive Framework jurisdictions, with minimal potential for variances among countries that would raise compliance burdens on affected taxpayers.

12. Tools to effectively prevent and resolve protracted disputes are required across the spectrum of contemplated rules. *Business at OECD* strongly believes that **a robust system providing mandatory and binding prevention and resolution must be a component** of any agreed Pillar One framework to resolve the inevitable disagreements that will arise under these new rules. **Mandatory binding dispute resolution mechanisms in particular are needed** to ensure that mutual agreement procedures (MAP) work properly by incentivizing timely government consideration.

13. With regard to Pillar Two, we agree that **the primary rule should be the IIR**, with all other articulated rules (UTPR, STTR, and SOR) only acting as a backstop when necessary. Because of the inextricable complexity these secondary rules have in interacting with the IIR, it is very important that the operation of these rules is consistent and coordinated. Clear guidance from the OECD is required, including a strong message that unilateral measures that are inconsistent with the agreed framework should not be adopted.

14. We also believe that providing **meaningful simplification will be critical** to ensuring that Pillar Two can achieve its articulated policy goals in the least burdensome manner. We encourage the OECD to further develop the options outlined in the Blueprint and other potential options.

15. Although not part of the Public Consultation Document, we have provided some comments on the Secretariat's economic impact assessment in an Appendix. We believe that the presented data has numerous shortcomings that once addressed should lead to a revised assessment in order to better understand the likely effects that Pillars One and Two will have on revenue collection and investment.

16. We are pleased to provide input below on the issues requested for public comment in the Public Consultation Document.

Benchmarking the Blueprints against our Business Principles

17. In January 2019, *Business at OECD* (BIAC) published 11 principles[1] that we consider it imperative to respect in addressing the tax challenges of the digitalization of the economy.

We have taken this opportunity to provide an initial benchmarking of the Pillar One Blueprint and Pillar Two Blueprint against these Business Principles to demonstrate the areas of greatest alignment and challenge.

(see the dashboards on the following two pages)

[1] *See Business at OECD*, Business Principles for Addressing the Tax Challenges of the Digitalizing Economy (Jan 2019), http://biac.org/wp-content/uploads/2019/01/FINAL-2019-01-21-Business-at-OECD-Digital-Principles-Position-Paper.pdf.

Pillar One Blueprint Dashboard

<table>
<tr><th>BIAC Principle</th><th>Score</th><th colspan="2">Comment</th></tr>
<tr><td>Be based on long-standing and well-founded underlying principles of international taxation</td><td>🔴</td><td colspan="2">The proposal represents a significant departure from foundational transfer pricing rules and creates a new basis for nexus not based on physical presence for Amount A. No principle guiding the specific goals of this departure is offered in the Pillar One Blueprint.</td></tr>
<tr><td>Not ring-fence the digital economy</td><td>🔴</td><td colspan="2">The proposal continues to ring-fence some portion of the digital economy.</td></tr>
<tr><td rowspan="7">Respect the Ottawa Taxation Framework principles</td><td rowspan="7">🟡</td><td>Neutrality</td><td>No explicit discrimination of digital or remote sales.</td></tr>
<tr><td>Efficiency</td><td>Unclear at this stage; opportunities exist.</td></tr>
<tr><td>Certainty</td><td>Unclear at this stage.</td></tr>
<tr><td>Simplicity</td><td>Not at this time.</td></tr>
<tr><td>Effectiveness</td><td>Unclear at this stage.</td></tr>
<tr><td>Fairness</td><td>Opportunities for avoidance appear to be limited.</td></tr>
<tr><td>Flexibility</td><td>The proposals should keep pace with changing business models; formulaic elements and monetary thresholds reduce flexibility.</td></tr>
<tr><td>Be grounded in the concept of value creation</td><td>🟡</td><td colspan="2">The reallocation of taxing rights under Amount A appears arbitrary with no principle guiding the objective, and departs from the outcomes of BEPS Actions 8-10.</td></tr>
<tr><td>Reduce instances of double taxation</td><td>🟡</td><td colspan="2">We acknowledge the intention to prevent double taxation, but elements of the current proposal will increase the opportunities for double taxation to arise; it is critical that the proposed elements to eliminate it in new and existing cross-border allocations are strengthened. In addition, existing unilateral measures and certain withholding taxes must be clearly removed and future conflicting regimes strongly prevented.</td></tr>
<tr><td>Be introduced as a comprehensive package</td><td>🟡</td><td colspan="2">The proposal commits to implementation as a comprehensive package (alongside an evolving Pillar Two proposal) and also notes that coordination in entry into force is required. However, clear rules on dispute resolution and the repeal of unilateral measures and certain withholding taxes must also be included.</td></tr>
<tr><td>Be reflected in model treaties and commentary</td><td>🟢</td><td colspan="2">The proposal recognizes that effective multilateral implementation requires robust mechanisms (such as treaty changes or other instruments).</td></tr>
<tr><td>Provide tax certainty for taxpayers and tax administrations, including strong dispute resolution mechanisms</td><td>🔴</td><td colspan="2">Without a guiding light in the form of clearly articulated principles, the proposal is still too broad and complex to give taxpayers certainty. Also, apart from stating that Pillar One precedes Pillar Two, nothing is mentioned about the spillover effect between the two Pillars.</td></tr>
<tr><td>Have global agreement</td><td>⚫</td><td colspan="2">N/A at this time.</td></tr>
<tr><td>Minimize the administrative burden on taxpayers and tax administrations</td><td>🟡</td><td colspan="2">The proposal recognizes some of the administrative challenges that it will cause, however, much more detail (and creative thinking) will be required to address these given the ensuing complexities.</td></tr>
<tr><td>Be developed through inclusive consultation with all businesses and other stakeholders</td><td>🟢</td><td colspan="2">We welcome the opportunity to comment on the proposals and have the business community engaged in the development process.</td></tr>
</table>

Pillar Two Blueprint Dashboard

BIAC Principle	Score	Comment
Be based on long-standing and well-founded underlying principles of international taxation		The proposal introduces a new feature to the international tax system by way of a multilateral minimum tax but has not yet clearly defined the principles underlying Pillar Two. Further analysis of the effect of BEPS implementation is warranted before taking action in this area.
Not ring-fence the digital economy		The proposal does not appear to ring-fence any portion of the digital economy.
Respect the Ottawa Taxation Framework principles		Neutrality: No explicit discrimination of digital or remote sales. Efficiency: Unclear at this stage; opportunities exist. Certainty: Not at this time. Simplicity: Not at this time. Effectiveness: Unclear at this stage. Fairness: Opportunities for avoidance appear to be limited. Flexibility: The proposals should keep pace with changing business models; formulaic elements and monetary thresholds reduce flexibility.
Be grounded in the concept of value creation		The IIR will give taxing rights to the UPE jurisdiction, and UTPR will give taxing rights to jurisdictions where a service recipient is located, regardless of where the value is created. The current proposals do not adequately address timing differences and will therefore result in permanent tax liabilities as a result of timing differences, rather than where there is a true undertaxed economic profit.
Reduce instances of double taxation		There is the serious potential for double taxation arising from interactions among the IIR/UTPR/STTR elements, as well as not adequately addressing timing differences that will result in additional tax liabilities even where the economic effective tax rate is higher than the global minimum tax rate (i.e., double taxation).
Be introduced as a comprehensive package		The proposal commits to implementation as a comprehensive package (alongside an evolving Pillar One proposal) and also notes that coordination in entry into force is required. However, no framework is available or proposed to clarify the interaction of the various components or existing legislation. Dispute resolution must also still be included.
Be reflected in model treaties and commentary		The proposal recognizes that effective multilateral implementation requires robust mechanisms (such as treaty changes or other instruments). However, certain aspects seem at least in breach with the EU treaty.
Provide tax certainty for taxpayers and tax administrations, including strong dispute resolution mechanisms		The proposal is still too broad (and lacking in detail) to give taxpayers certainty.
Have global agreement		N/A at this time.
Minimize the administrative burden on taxpayers and tax administrations		The proposal recognizes some of the administrative challenges that it will cause, however, it has not yet acknowledged the need for a risk-based simplification approach to address these. The constituent entity by constituent entity calculation needs and per-jurisdiction blending approach are of particular concern.
Be developed through inclusive consultation with all businesses and other stakeholders		We welcome the opportunity to comment on the proposal.

PILLAR ONE BLUEPRINT – Technical Comments

Chapter 1. Amount A – activity test

18. To reduce administrative burden and prevent disputes, the activities test must be clear enough to ensure businesses have an accurate understanding of which activities fall within scope and enable review panels to reach consistent decisions on businesses' scope evaluations, thereby providing tax certainty. While our members have differing views on the specifics of the proposed activity test related to Automated Digital Services ("ADS") and Consumer-Facing Businesses ("CFB"), consensus is that detailed scope limitations based on business models do not create a simple model. For these reasons, among others, business respectfully requests that the design of the proposed activity test be objective, clear, and straightforward to follow and implement and that the proposal explore methods to minimize or avoid political and subjective discussions. In line with these goals, some members propose a gateway test that would exclude MNEs from the scope of Amount A if: (i) in-scope revenue was less than a certain amount (e.g., 10%) of total financial statement reported segment revenue or total enterprise value, or (ii) profitability thresholds were not met (i.e., a segment would be considered out of scope if PBT/revenue based on reported segments were below a certain percentage – 75%, for example – of the profitability threshold). Business suggests that decentralized businesses should not be required to go through Amount A calculations and possible segmentation if it is clear upfront that ultimately no or minimal profit is to be reallocated (i.e., local PBT/revenue ratio must exceed a stated profitability threshold). Some members propose such a safe harbor test could be based on CbCR data.

19. Some members also query whether the distinction between ADS and CFB is overcomplicating the model, or whether the existence of ADS as a separate category conflicts with the Inclusive Framework's long-espoused view against ring-fencing the digital economy. [2]

20. In this regard, some members suggest that an alternative could be to adopt a more formulaic approach (such as profit margin, or other ratios) as the basis for defining what is in or out of scope, or using this same metric to exclude businesses from scope of Amount A if they have a relatively low return on assets.

21. There is general agreement, however, that if there is a need for scoping, there should be much clearer definitions to delineate in a consistent way what business is in scope or not. Within this context, one of the criteria that could be considered is whether the consumer has a choice to buy a certain good, or whether this decision is made by a third party.

22. Members broadly welcome achieving early certainty on scope through the review panel process, but also acknowledge potential limitations in achieving this certainty absent straightforward guidance that can be consistently applied and adequate allocation of resources to the panels to ensure timely and consistent decisions. While swift agreement among Member States on whether a service or good is in or out of scope may be unlikely, agreement will not be possible at all unless the positive list is clearly enumerated.

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[2] There is concern among some members that the Blueprints take a step towards ring-fencing the digital economy again, for example, in widening its scope to business-to-business sales for ADS but almost entirely excluding it from CFB, or by requiring plus factors to be met for CFB to have nexus but not applying this same standard for ADS.

23. For example, the sale or other alienation of user data is described as "selling, licensing or otherwise alienating an unrelated 3rd party customer user data generated by users of a digital interface," but there is not much clarity around what "other alienation" means and whether the term could include transferring data without payment (whether free-of-charge digital content services referenced in the commentary are out of scope should also be clarified). Likewise, it would be helpful to specify who (e.g., a natural person and/or a business) qualifies as a "user" with respect to references to "user data" in the commentary. In this respect, a more comprehensive definition of "user data" might also reflect whether data qualifies as "personal data" for purposes of GDPR.

24. With respect to the negative list, the definition of "services providing access to the Internet or another electronic network" does not elaborate on the type of services. It should be clarified whether the exclusion covers services relating to network infrastructure and communication service provision (CSPs), as both are required for end-users to gain access to the internet. A service closely linked to internet access (e.g., invoicing system or network analytics) should be considered out-of-scope to provide for clarity and simplicity.

25. Members note that the activity-based test is "designed to capture the MNEs that are able to participate in a sustained and significant manner in the economic life of a market jurisdiction without necessarily having a commensurate level of taxable presence in that market." In this respect, the Blueprint does not sufficiently demonstrate how current tax and OECD rules (notably, transfer pricing principles, as well as BEPS) fail to achieve appropriate taxation. There is concern by many members that the proposed Pillar One goes beyond the stated goal of capturing those businesses lacking the necessary commensurate level of taxable presence in markets, instead extending a broad reach while neglecting to provide a principle-based explanation for why the current regulatory framework is not sufficient or could not be altered with minimum effort to address the taxation concerns. Consistent with this concern, one way to avoid double counting issues is to provide that all industries that have applied policies where operations get taxed in local jurisdiction markets under existing enumerated tax principles or are already subjected to tax in market jurisdictions via withholding taxes should be out of scope of Amount A.

26. Some members note that the reasons for including CFB in the scope of Amount A are vague and do not seem to match the policy justification for Amount A which is clearly and repeatedly focused on MNEs that do not have a "commensurate presence" in a market. In practice, most CFBs design, manufacture, market and sell products in essentially the same way that they always have done. Because CFBs structurally have typically always had a substantial and taxable presence in markets and are not typically characterized by scale without mass, the rationale for introducing Amount A does not seem to apply to them. Additionally, many of the rationale for carving out specific sectors (e.g. business-to-business sales) would equally apply to CFB.

27. For both ADS and CFB, it would be helpful to clarify the reference to "activity" in relation to the definition of market jurisdictions "where activity usually takes place." Based on feedback we received, without more detail, the term "activity" is confusing. Consistent with the approach and objectives, it would seem the focus would be exclusively on the existence of "(end) user/consumers."

28. Currently the Blueprint proposes that licensing of IP to connected consumer product or service would be in-scope activity for Amount A purposes. However, there are instances where the licensor does not have a "face" apparent to the consumer, and the licensed IP is not of a type that would be typically licensed to a consumer, as mentioned in the general

definition. A consumer would rarely know whether a consumer product or service involves licensed technology, with the potential exclusion of brand licensing, where the consumer might recognize the licensed brand in the consumer product or service. From this perspective, we suggest consideration of whether patent and other IP licensing, business-to-business IP licensing, and other arrangements where the licensor is not clearly identifiable to consumers could be treated out of scope for Amount A purposes. Where brand licensing or franchising is included on the basis of goods or services and their associated brand contemporaneously 'facing' the consumer, then that principle should be followed through consistently when considering ADS exclusions for franchisor-run platforms for sales of own brand goods or services.

29. The design and implementation of the proposed activity test should not only be clear and straightforward to alleviate additional administrative burden, but also should take into account the future evolution of business models. Lack of clarity of in-scope and out-of-scope businesses may also create competitive distortions within industries.

30. The Blueprint suggests that the scope list will be updated from time to time, allowing "rapid changes." However, more clarity should be provided on the updating process, and agreeing on widening the scope is likely to be difficult. There is also concern among business that allowing individual jurisdictions to make unilateral changes to the positive and negative lists will greatly increase uncertainty, disputes, and the potential for double taxation. The positive and negative lists should take a consistent approach to including or excluding businesses from the scope of Amount A, aligned with the underlying principles of Amount A and consistent with existing tax principles and policy objectives. Given the integral role these lists will serve in demarcating scope, there should be high importance given to the process and frequency by which they will be updated. A special process for engagement with business on the initial drafting of these lists is essential.

31. Some members believe the framework should exclude products sold through intermediaries from the scope of Amount A where the relationship between the MNE and the intermediary is such that the MNE does not have access to information regarding sales to end users in particular jurisdictions. If the marketing jurisdictions were to extend their taxing right to the foreign retailers that are selling to end users in country, that would be a more logical extension of their taxing right to businesses that can comply with the requirements of this Amount A. [3]

<u>Specific Issues for Business Lines</u>
Members have offered the following comments on various sector-specific issues:

Cloud Computing

32. Cloud computing services are a productivity tool and neither satisfy the stated justifications for Amount A nor fit within the criteria for inclusion in Amount A. The need to minimize network latency issues and network capacity demands require significant capital investment in or near the location of customers, limiting the ability of cloud service providers to achieve scale without mass. While cloud service providers do not have to locate data centers in every jurisdiction, no large MNE has a physical presence in every customer jurisdiction, so that should not be a negative distinguishing factor for cloud services. The major cloud

[3] Some members suggest that where an MNE group's revenue is derived predominantly from excluded activities, the group should be excluded from Amount A entirely. Another view is that the provision of business-to-business goods and services, similar to intermediate/component products, should not be in-scope as ADS activities.

services providers do in fact have taxable physical presence in their major markets covering the large majority of their customer revenue.

33. Cloud services have minimal brand recognition with users in the market. Cloud services companies (i) do not generally track specifics of user engagement, other than usage of the cloud services, (ii) do not benefit significantly from direct interaction with users and customers or from users' data and content contributions by users, and (iii) do not generally monitor specific user activities or benefit from the resulting data. In addition, concerns regarding competitive advantages for cloud computing overlook the fact that there are no non-digital competitors in this industry space (i.e., the very essence of cloud is its digital nature).

34. Despite the significant reasons for excluding cloud computing services from the positive list, if they remain in-scope, there is a need for further guidance on "standardized cloud computing services" versus "bespoke cloud services," as there is a view that the degree of cloud service configuration generally depends on a customer's needs and therefore, the determination when the services are "bespoke" will vary by customer. Cloud service installations for major MNE, healthcare, and government customers require significant design, internal legacy IT system integration, and ongoing security and issue identification and management services requiring the attention of highly skilled individuals. Medium-size enterprises likewise have a significant need for pre- and post-implementation support.

35. We also received feedback from members that the definition of digital content services should exclude companies providing software (e.g., through licenses) to other businesses (business-to-business software transactions) on the basis that software provided to another business is a business input, intended to make the business more efficient and productive .[4] In this regard, it may be considered similar to intermediate products or components that businesses sell to other businesses. Such businesses should not be in scope for Amount A, just as businesses selling such intermediate products or components are out of scope for Amount A. Moreover, it is a generally accepted principle of international taxation, which the OECD has confirmed in its model treaty commentary, that the sale or license of standard software products is classified the same as a sale of a tangible good (assuming no software copyright exploitation rights are granted apart from the right to distribute the product). There is no logical rationale for taking a different position in the Amount A context and classifying such a sale or license as a digital content "service."

36. When considering the "automated" element of ADS, "human involvement" should not be limited to engineering/consulting services but cover a broader range of in-country activities that point away from full automation. For example, this could be expanded to include customer relationship management, direct sales/marketing effort, contract management, customer pricing, etc. As an alternative, further scope limitations could consider business models (even ADS and cloud computing businesses) that are still predominantly landed models, characterized by long sales cycles, with revenues reported at customer location. These business models are currently taxed under existing PE attribution and nexus rules and there should be a clear carve out for such businesses or lines of business even if such companies are deemed to fall within the ADS definition.

[4] According to this same rationale, cloud computing services provided to another business likewise should be excluded from the scope of Amount A, as they are business inputs.

Pharmaceuticals

37. With respect to pharmaceuticals, the Blueprint specifically raises the question of the appropriate level of inclusion and offers two options: (i) having all pharmaceutical operations in scope, or (ii) limiting the scope of inclusion to over-the-counter ("OTC"), non-prescription businesses. Pharmaceutical businesses strongly oppose a broad-based inclusion of all pharmaceutical operations for a number of reasons, fundamentally because the inclusion or exclusion of any particular industry should not be based on its profitability or use of intangibles, but rather because of a principle-based definition. Notably, the pharmaceutical industry shares similarities with other industries whose activities are deemed out-of-scope and should not be presumed to have generated profits from base-erosion and profit shifting as the profits need to be viewed in the context of the significant level of costs incurred over a number of years in order to generate profits.

38. As an initial matter, further clarity is needed on the precise definition of OTC, as this may vary across countries. While the overall objective of the current public consultation is to simplify the Blueprint framework, we strongly encourage clear classification of businesses and activities to avoid burdensome operations, with some multinational enterprises being in scope in a country for a certain amount of activities, and not in others.

39. The Blueprint justifies the inclusion of the total pharmaceutical industry on "how the MNE places its products in the market and engages with a consumer . . . in other words, looking to the nature of the product and not to the specific supply chain." However, this completely ignores the high degree of regulation, intermediation and pre-validation within the pharmaceutical value chain and the nature of the market and its products.

40. The pharmaceutical market and value chains are already highly intermediated and regulated, from the way in which R&D is performed, to how the products are manufactured (GMP), distributed (GDP), marketed (code of conduct), priced (whether directly or indirectly regulated) for sale, as well as the information that then needs to be collected for each of these value chains steps. The product is, during the entire value chain, validated by regulatory agencies on its therapeutic benefits, safety, efficacy, compliance and its qualitative (efficiency and efficacy) and quantitative (price) value proposition for the patient and community.

41. Prescription drugs, if finally used by an end patient, are not meant for direct access to consumer, but instead, are offered, (pre-)validated and monitored by medical doctors to patients who do not have a choice and usually have no preference as to the drug ultimately administered. In this respect, statements in the Blueprint that "marketing directed to medical professionals, insurers and drug purchasing authorities" evidences "sustained engagement with the market" and is a factor for including prescription medicines in-scope is arguably contradictory with the general approach adopted and being applied to other industries, as set out in Blueprint box 2.32. Here the general definition of a "consumer" excludes individuals who acquire good or services "for commercial or professional purposes" and key factors for being "of a type commonly sold to consumers" are being "at purchase points accessible by an individual" and where the MNE is engaged in "marketing and promoting it to consumers." Advertising for drugs is never permitted in countries, with the exception of New Zealand and the United States.

42. The Blueprint rightfully addresses the fact that pharma industry profits are impacted by regulators, public health policy considerations, and health insurers. However, perceived profitability of the industry should not be the decisive factor for de facto, broad-based inclusion in Pillar One. At the same time, such value impacting regulatory influence will

remain decisive for the residual non-Amount A profits, which still continue to be governed by the OECD Transfer Pricing guidelines. There is concern that applying this dual and contradicting set of rules (Pillar One and the OECD Transfer Pricing guidelines) simultaneously to the total profits is selective, inconsistent, and will lead to more disputes with tax authorities.

43. If the scope of inclusion is limited to OTC/non-prescription businesses, which members consider a better reflection of the innate characteristics of prescription versus OTC medicines and how they are delivered to patients, further clarity should be provided on what qualifies as OTC. In this regard, a potentially straightforward and equitable outcome would be to follow the classification of a particular drug as OTC/non-prescription based on the approach adopted in the majority of markets, either by number or turnover, and it is likely that pharmaceuticals would segment their OTC and prescription businesses in any event. The turnover metric would have the benefit of better aligning the classification to how profits are generated (i.e., either through prescription or OTC/non-prescription sales).

Extractives

44. We agree that extractives should be carved out from application of ADS and CFB. Industry members believe the same policy justifications equally support the exclusion of the entire value chain of non-renewable natural resources, including petrol, diesel and lubricants, whether branded or generic. The same considerations can be applied to new and renewable energies, such as hydrogen, wind, and solar electricity, etc.

45. Generic petrol, diesel, and lubricant base stocks are fungible commodities whose price is completely dependent on global supply and demand dynamics, with the consumer having complete transparency into the ultimate price through global or regional indices or benchmarks. Petrol, diesel, and lubricant base stocks are manufactured from natural gas and crude oil; however, any processing of crude oil and natural gas into petrol, diesel, or lubricant base stock is largely standardized across the industry in order to satisfy government regulations or automobile specifications. Said another way, these generic products are identical regardless of the company producing the product, meaning consumers cannot distinguish between companies or end product, and there is no intangible value associated with the process to create or sell the product. In fact, these generic products are often transferred between unrelated parties many times as the product travels from the manufacturing facilities to the end consumer, as global companies balance their own supply and demand.

46. Branded petrol, diesel and lubricants are distinguishable from their generic counterparts only in the sense that they include a relatively small amount of additives. The base of these products is a generic commodity; any associated brand value is slim, given that products retain their character as commodities. Moreover, manufacturers of branded petrol, diesel, and lubricants routinely source their generic component from the open market, without regard to the original manufacturer. Marketing and brand awareness to end consumers are not a revenue driver for the energy industry (as has been proven by external research); instead, revenue is determined based on the product's inherent, fungible characteristics. External factors such as convenient location, quality/cleanliness of brick and mortar store, and perceived expertise of a mechanic are more influential on a consumer's decision to purchase petrol, diesel or lubricants, rather than brand. Further, significant competition in both the manufacturing and retail sector ensures that prices remain reflective of the market dynamics and tends to force lower margins.

Business Format Franchising

47. Business format franchise models are common in the restaurant and hotel industries, and have been used in those industries for decades. Goods and services in those industries cannot be provided remotely to consumers; rather, they can only be provided through substantial physical facilities in the location of the consumer. Nonetheless, the Pillar One Blueprint includes them in the proposed scope of Amount A.

48. Under traditional international tax principles, the profits of both franchisees (which are often independent of the franchisor) and franchisors are subject to market taxing rights. The profits of franchisees, which may represent a high proportion of franchisor-franchisee profits that are rationally connected to the market, are subject to market jurisdiction income tax. In addition, the franchisor often is subject to market gross-basis withholding tax on franchise fees, royalties, or similar payments from the franchisee.

49. Because the profits from business format franchising businesses are already subject to significant market taxation, and because these profits are divided between unaffiliated franchisors and franchisees, the inclusion of business format franchisors in the current Amount A framework raises significant issues. In the context of determining the Amount A tax base, focusing only on the results of franchisor MNEs ignores the profit margin generated by franchisees from use of the business format and can distort the determination and allocation of Amount A. Absent significant refinements, the determination and allocation of Amount A in this context will depend on the extent to which franchisees are affiliated or independent, and the extent of incidental franchisor presence in a market, which is not consistent with the objectives of Pillar One or any rational international tax system. The marketing and distribution safe harbor, which may be utilized in markets served by affiliated franchisees, but not in markets served by independent franchisees, again has the potential to distort results among markets in a manner that is inappropriate. Finally, coordination is required between existing withholding taxes and the Amount A framework, for example by either eliminating withholding taxes or by allowing an offset against Amount A tax for any withholding tax paid. The failure to do so is inconsistent with sound tax policy and with the stated intent of Pillar One, which is to supplement market taxing rights where existing market taxing rights are deemed inadequate.

50. We encourage the OECD to engage directly with affected businesses: (1) to reconsider whether traditional international tax principles already provide adequate market taxing rights such that business format franchisors should be excluded from the scope of Amount A, and (2) if business format franchisors remain in scope, to provide more robust and tailored mechanisms to prevent the distorted Amount A outcomes based on whether franchisors operate through affiliated or independent franchisees, and to relieve double counting and double taxation. We believe that it is critically important to address these issues in a manner that does not impose any additional burdens on independent franchisees, many of which are small businesses.

Financial Services

51. We support the proposed carve-out for all financial services, and in order to avoid ambiguity recommend adding a clarification that all types of insurance, including health, are included in this definition of financial services.

52. We recognize that the Blueprint (para. 129) currently carves out payment processing for financial services groups. However, how the carve-out applies to payment processing should be clarified, including the case where stand-alone payment processing businesses are not part of an overall banking or lending business. While the regulation applicable to payment

processing businesses conducted by entities that are not themselves banking institutions is substantial, it may vary from country to country. Furthermore, such regulation continues to change over time as countries address matters of particular relevance within their markets. The recent trend is increased regulation and operational restrictions for payment processors. Focusing on the precise contours of regulation applicable to banks, payment processors, and e-money services runs the risk of different treatment of nearly identical activities depending on the overall makeup of the group and the jurisdiction in which their activities are conducted. Further, a carve-out driven by the specifics of regulation is overly complex and difficult to administer – by virtue of the complexity and divergence of such regulation as well as its constant flow of change. Focusing instead on the nature of the activities performed appears substantially more administrable and is more likely to yield a result that carves-out only those businesses that do not present the policy concerns of Amount A. An activity-focused approach would avoid creating competitive imbalance between payment processing providers that are banks and/or governmental or quasi-governmental entities and those that are not.[5] We would therefore recommend making it abundantly clear that the carve-out is equally applicable to groups undertaking payment processing activities.

53. In addition, to provide simplification and ease administrative burden in the case of low-risk groups, we suggest that where an MNE group's revenue is derived predominantly (e.g., 70% or more) from excluded activities, the group should be excluded from Amount A entirely.

Automated Transport Systems

54. With respect to the negative list, automated transportation system services should be clarified to be appropriately characterized as internet-of-things (IOT), and thus included on the negative list of ADS businesses. Automated transportation systems are the key enablers for autonomous driving and as such, are responsible for globally transforming the mobility of people and goods. Consistent with the way IOT is defined under the Blueprint, automated transportation systems are inextricably linked to the physical product, and merely leverage network connectivity functions as a means of improving the quality of that product. While the network connectivity feature enables automated transportation systems to collect information from users, that data is used to help the vehicle navigate its environment and achieve the functionality of an automated vehicle. Moreover, the deployment of automated transportation systems, without more, does not implicate any activity that would prevent it as being appropriately characterized as IOT. For example, deploying automated transportation services does not require separately monetizing the data gathered through the operation of the system (e.g., by selling "data about the user's habits [and] location...to third parties for marketing purposes," see Box 2.28 of the Blueprint).[6] For the foregoing reasons, member companies believe automated transportation services merit a clear articulation that they are appropriately considered to fall within the definition of IOT under

[5] These members note that all current Digital Services Tax regimes that initially include digital networks within scope have specifically carved-out payment processing activities; this is because payment processing does not present the digital tax concerns that underly the origination of DSTs and Pillar One.

[6] We note that automated transportation systems can be leveraged to provide ancillary services that would involve monetizing user data. Revenue streams from such ancillary services will generally be easily distinguishable from those generated from selling products equipped with an automated transportation system. We believe ancillary revenue streams arising from the monetization of user data may appropriately be categorized as one generated by an ADS business (as described on the positive list). However, the presence of an ancillary revenue stream should not operate to recharacterize the entire revenue stream generated by the automated transportation system as an amount generated through the operation of an ADS business.

the Blueprint. Doing so would be consistent with the policy intentions underpinning Pillar One and the IOT definition already contained in the Blueprint.

Dual Category Rules

55. As cloud becomes of increasing relevance to business operations across industries, there will be increased bundling of services and the "dual category of ADS and bundled services" will become increasingly complex. Any determination of "appropriate materiality," "substantial part," or "ancillary" will result in future controversies that do not appear justified by the level of risk presented by dual category services. In this respect, the additional guidance on dual-category ADS and bundled packages does not resolve this uncertainty.

56. For dual use intermediate products and components, the Blueprint's approach is to include only sales of those products that are actually sold to consumers. However, for intermediate products/components, the sole purpose of which is to get incorporated into a finished product for end use, the business is even less likely to have gone out of its way to engage with the market jurisdiction end users. This even less direct nexus between the business and the end user further reduces the visibility required to comply with Amount A calculations. Making the taxpayer trace through its sales channels to isolate the consumer sales to end users unfairly places a practically impossible compliance burden on the business and will likely lead to more dispute with the market jurisdictions.

57. Due to the uncertainty and subjectivity these rules would introduce into the determination of whether a particular activity is in scope, we recommend that consideration be given to simply eliminating the special dual category rules. If they are retained however, the determination of whether an activity is in scope could be made based on the predominant character of the relevant entity, rather than through the introduction of new concepts, such as whether ADS elements constitute a "substantial part" versus an "ancillary element" of an overall service. If the rules are retained, further clarity is also sought on dual-use finished CFB goods and services and dual-use intermediate products and components, where the complexity of splitting revenue between business-to-business and business-to-consumer is very burdensome, and for this reason potentially should be fully out of scope of Amount A.

Chapter 2. Amount A – revenue threshold

58. With respect to the design of the Amount A revenue threshold, there is broad support for a global threshold greater than €750 million at the outset of implementation, with the potential to revisit the revenue threshold within a few years. Our members believe the de minimis threshold for Amount A should be kept reasonably high, in the hundreds of millions of Euros range, with the possibility of a phase-out over a period of time and potential application per segment. Nonetheless, while business generally agrees that it is important that Amount A be limited to a manageable number of MNE groups, there is caution against thresholds (or phased-in thresholds) that would result in a concentration of in-scope businesses in a particular industry or country, while other countries' national champions are exempt or deferred as it would not result in an equitable playing field. As a result, any phase-in approach should include a mandatory timeline for a full roll-out (with an economic impact analysis supporting such an approach).

59. There is also concern that identifying the domestic market based on the ultimate parent or other criteria could be challenging to undertake, undermining any objective of simplicity, while also producing outcomes that might not serve the intended purpose. For example, if the home market for a product is determined based on the jurisdiction where the parent is located or sales of a different product are primarily driven from or made, some companies

question whether this could lead to possible discrimination of MNEs in smaller economies or home markets who have relatively larger foreign markets.

60. More generally, the Blueprint offers no clear or consistent concept of what 'domestic' should mean in the context of the relationship between the market location identified by the new revenue sourcing rules and the resident location of the entrepreneur involved in making those supplies under existing principles. The most logical interpretation is to view a transaction as 'domestic' where those market and resident jurisdictions are the same. For decentralized business models, however, there may be multiple 'domestic' markets.

61. It is preferable that a more generally applicable concept of 'domestic' be developed and applied (as set out above) which could be used by those decentralized business models who already recognize and are taxed on the vast majority of their profits in the same jurisdictions as those identified as the market jurisdiction under the new revenue sourcing rules. If a more limited exclusion for centralized business models is envisaged, however, then a mixture of criteria for determining the home market could be set forth. For example, the home market could be: (i) where the ultimate parent entity is located and where x% of qualifying revenue is generated, (ii) where there is presence of the MNE and x% of qualifying revenue in a market different than the country where the ultimate parent entity is located, or (iii) where a significant percentage of qualifying revenue was generated, even if there were no other presence of the MNE. For example, Pillar One could exclude a MNE from Amount A if more than X% of sales arising from in-scope goods or services come from within a single jurisdiction where the threshold is significantly high, such as 90%, to ensure that Amount A market allocation is not easily defeated.

62. If a de minimis rule for foreign markets is deemed necessary, a combination of both an absolute and relative figure could be considered to determine whether the de minimis amount is reached. For example, if revenue is €750 million and there is a €60 million threshold, this would mean a relative figure of 8%, but in the situation where a company has revenue of €1.5 billion with the same revenue threshold of €60 million, the relative figure is just 4%. In the latter example, the compliance burden arising from a static de minimis threshold may still be significant for what is a low amount of market presence relative to a MNE's total revenues.

63. MNEs ordinarily do not establish a presence in a jurisdiction until certain revenue thresholds are met. As such, care must be taken to prevent an administrative nightmare just to allocate a small return to jurisdictions without a permanent establishment; in any case, such allocation should not include routine returns, which are properly due to the jurisdiction in which there are functions, assets, and risk. There should be a balanced approach between the potential effort to try to collect such information, the definition of active participation, and the limited portion of Amount A that might be allocated in markets where the MNE is not established. Where an Amount A nexus is deemed to exist, local administrative requirements should be kept to an absolute minimum by full development of centralized 'one-stop shop' compliance approaches which enable automated central calculations and payment processes for all jurisdictions.

64. The Blueprint leaves open any sales revenue thresholds, however, where the thresholds for both ADS and CFB are low (e.g., below €5 million), this would likely trigger nexus in all market countries of MNEs liable to pay an amount under Amount A. Business recognizes that defining possible nexus market revenue thresholds is a difficult task, trying to balance between equal tax revenue benefits for small and/or developing countries and on the other hand trying to limit the administrative burden on MNEs. In this respect, we emphasize the

points raised above regarding the importance of developing clear scope limitation rules and raising the global revenue threshold above €750 million. We believe that, if using country-specific sales revenue thresholds, the cost of reporting tax should not exceed the tax itself. For example, a threshold representing an average compliance cost could be a limit under which no tax will be due, or else settling on a limit tied to a percentage of the general revenue threshold (e.g. 5%).

Chapter 3. Amount A – nexus rule

65. According to the Blueprint, MNEs would be subject to a new nexus rule by participating in an active and sustained manner in the economic life of a market jurisdiction. However, there is scant detail on what such participation means (including what "remote" means), and so further clarity should be provided in this regard. Likewise, the Blueprint introduces a new concept of deemed permanent establishment that requires no participation except for sales and broadens the scope of participation to include, e.g., third-party distributor activity or third-party licensees. If "sales" are the trigger to assume an active and sustained participation in the economic life of a market jurisdiction, it might be helpful to make a distinction between direct sales by an MNE to the end customer, versus indirect sales which involve third parties. Determining the amount of indirect sales might be very challenging (if not impossible) as an MNE is unlikely to have visibility into the full supply chain leading up to the sale to the end customer because of the complexity of the supply chain and the different layers of intermediaries. For the same reasons, a third-party distributor or licensee might not have such visibility.

66. The primary objective of the nexus rules is to allocate taxing rights without taxable presence. However, the rationale for the requirement for additional "plus factors" beyond a mere revenue test to conclude nexus for the new taxing right for CFB is unclear. Many of our members believe that the additional plus factors suggested for CFB beyond sales would create significant additional complexity to assess the factors and an associated compliance burden, which may deter businesses from expanding and investing overseas if doing so would create a plus factor that creates a sizable compliance burden. There is concern that the compliance cost relative to sales, as well as the total tax burden, will become unreasonably high for smaller markets, resulting in an inability for the company to provide products for sale in that market. To the extent the plus factors are retained, some members believe they should apply equally to both CFB and ADS, and should relate to the marketing and sales end of the value chain and not to production-related functions such as R&D on new products or processes. Other members agree with the Blueprint's acknowledgment that the ability of CFB businesses to participate remotely in market jurisdictions seems less pronounced compared to ADS and therefore should not automatically lead to a disqualification of such "plus factors" for CFB. Accordingly, this group of members sees the application of the "plus" factors as actually limiting the scope of Pillar One for CFB and therefore also significantly reducing complexity.

67. Moreover, because the plus factors are built on a minimum sales level plus additional indicators, this will require sales/revenue figures on a per-country basis. A deemed engagement revenue threshold may be easier to comply with — similar thresholds apply in the VAT context, where local VAT registrations are required if certain sales thresholds are surpassed.

68. Some members are of the view that it may be useful to determine whether an ADS or CFB company has a physical presence such as a subsidiary or PE in the market jurisdictions. This could reduce the number of countries in which a new nexus is created because CFBs and

ADS businesses are already paying tax in the country where they have a subsidiary or PE. The Blueprint proposes to establish a single self-standing "group PE" provision in the tax treaty (para. 207-211). The definition of group PE should be clear and leave no room for arbitrary interpretation. It is not appropriate to determine whether a group PE exists based on criteria that are difficult to measure, such as advertising and promotional activities.

69. Additionally, there is concern with the suggested approach to deem the suggested plus factors as met (and taxable nexus under Amount A) once a certain level of sales is exceeded. Based on member input received, the deemed permanent establishment might be an added complication, rather than simplification, that could be frequently challenged by tax authorities and also has the potential to erode the traditional concept of permanent establishment. To the extent the plus factors are retained, members suggest that, for simplicity reasons, the nexus rules follow the current permanent establishment rules under existing tax treaties (i.e., when an MNE has a taxable permanent establishment under any tax treaty, the plus factor would be deemed met).

70. For these reasons, the requisite market connection to denote engagement with the market should be defined clearly, in an administrable way. If such definition is not possible, business recommends eliminating plus factors – or providing an election for business to opt out of the plus factor thresholds – and simply setting a minimum revenue threshold to establish nexus. Remote sales revenue booked outside a market jurisdiction above an appropriate threshold should be sufficient to be included in Amount A (for both ADS and CFB), which would be a significant simplification for both tax administration and tax compliance. Some members disagree with the Blueprint's assertions that different threshold amounts for ADS and CFB could be justified on the basis that profit margins are typically lower for CFB compared with ADS. Meanwhile, "physical presence" remains relevant for the marketing and distribution safe harbor, which should apply for all MNEs in-scope for Amount A.

71. For most businesses, country-specific thresholds would result in greater compliance costs due to more nexuses emerging based on country-specific and changing limits. While a single threshold would be easier to manage, we acknowledge the need to consider varying the threshold for smaller and developing countries. If this is the case, business proposes that country-specific thresholds should be standardized or categorized to avoid added compliance costs associated with individual countries establishing their own thresholds.

72. We also suggest that the market revenue threshold be linked to some temporal permanency, and overwhelmingly support including a temporal requirement of more than one year over the market revenue threshold to avoid isolated or one-off transactions triggering nexus, where the MNE's engagement with the market is not significant. Broad consensus is that nexus could be established only if sales met or surpassed a certain threshold over a three-year period, at which point the MNE could be considered to be engaged in a sustained and continuing manner in the market.

Chapter 4. Amount A – revenue sourcing rules

73. With respect to the proposed sourcing rule and hierarchy of indicators as the basis for sourcing revenue for Amount A, our members broadly support an approach consistent with information MNEs already collect, including to comply with existing tax rules, (including the ESS VAT rules, in the case of MNEs subject to those rules), as outlined below. Business notes that, even where possible (and not limited by the constraints identified below), building information-tracking systems is time-consuming and costly, and that it would be much easier if revenue sourcing for Amount A were based on location of sales because that is information businesses are already tracking and maintaining. In this regard, the multiple

simplifying changes to the hierarchy of sourcing indicators, along with elevating the customer billing address indicator to a number two position, are seen as a positive development. We note that the proposed sourcing rule and hierarchy of indicators used as the basis to source revenue for Amount A ideally should not be prescriptive, but rather allow greater flexibility in line with the underlying principles of Amount A to source revenues on a market destination basis (i.e., through statistical sampling or general estimations or approximations that can be demonstrated to be unbiased, reliable and true to the market destination-based principle).

74. In order to limit the number of MNEs that need to follow the revenue sourcing rule, it should be clarified that revenue sourcing is not required if the group's or segment's income before taxes is less than the internationally agreed profitability threshold (para. 454). According to the Blueprint, the de minimis foreign source in-scope revenue test stage (step 2) may require the calculation of the revenue per country, but if the overall process is modified to allow taxpayers to choose not to perform this calculation, then the number of MNEs that are subject to revenue sourcing rules can be greatly reduced, resulting in additional simplification.

75. Business strongly believes that the indicators should take into account any conflict with existing government privacy rules, such as European GDPR and similar legislation in other countries, that could otherwise limit the ability to collect or release certain information. Rules like GDPR have been implemented at a time when society is questioning the amount of personal data that is retained by companies. It would be an outlier to base the calculation of a new tax on personal location data, requiring companies to collect and store vast amounts of personal data for tax compliance purposes for an indefinite time. For this reason, our members suggest lowering geolocation in the rule hierarchy, based on a recognition that real-time tracking of individuals' locations is generally done only in limited circumstances (like crime prevention) and where data security can be ensured. If personal data is necessary to allocate taxes, its collection should be limited in scope to only what is necessary to facilitate taxation. Some members also commented that end users' adoption of privacy enhancing technologies would reduce the value of VPNs (or other similar emerging technologies) if users enabled VPN-applications blocking tracking.

76. The proposed approach to sourcing considers the location of end consumption or the location of users as the country location for revenue allocation wherever possible, which creates significant concern among our members (whether it be for business-to-business sales or any MNE sales that use third-parties in the supply chain/delivery channels). In addition, there might be other regulations such as the E.U. competition rules, which need to be accounted for in any requirement to collect destination information. For business-to-business sales, which are often multi-layered, a sourcing requirement based on the end consumer's location creates significant challenges in a number of contexts, including cloud sales, sales to third-party distributors, and advertising, where that information is not known or potentially knowable by the taxpayer. Our members comment that the end consumer location is not always ascertainable for business-to-consumer sales, and that in any case, for these sales, there nonetheless exist concerns regarding data privacy as outlined above.

77. Regarding the cloud sourcing rules, our members believe that cloud service providers' compliance should not be dependent on location information collected by third parties who may or may not have the information or otherwise be under any obligation to provide that information. There is concern that while taxation might justify a taxpayer's collection of certain geolocation or other relevant personal data, there might not be a legal basis for third parties to do the same. Moreover, requiring cloud service providers to collect information

on users or customers would exponentially increase the amount of data being collected. Mining that data, connecting it with financial data, and trying to ensure the accuracy of data of customers of the cloud service provider's customer would be a monumental task which could also violate business and governmental privacy policies. Many of these concerns equally apply to other types of sales to third-party distributors and to advertising, where a simpler approach would be to allocate sales to the country of the advertiser.

78. There are also different sourcing rules that apply to cloud computing services "intended for internal use by a business customer" versus those provided to individual customers. In this regard, some of our members believe it would be beneficial to include further detail on business customers (e.g., what is meant by "internal use," which businesses are eligible, and whether the jurisdiction of use refers to the jurisdiction of an individual company or all group companies), including serving as a platform host for another ADS provider (para. 275, fn. 50). Consistent with the discussion earlier in the draft, digitalization of the economy and the vital role cloud computing services pay in this respect are critical to fighting climate change, which mitigates against imposing additional compliance burdens. In light of the additional compliance burden imposed by the current sourcing rules for business customers, some of our members believe that business-to-business sales of cloud computing services should be excluded from the scope of Amount A for this reason.

79. To provide greater simplicity in application, we recommend having a clear, unambiguous set of rules to identify the customer location. Businesses should be provided with a level of flexibility based on information they have available and consider reliable, with appropriate limitations for the constraints of existing government data privacy legislation and taking other existing tax rules into account. In this respect, our members note that requirements should not increase transaction costs or otherwise adversely affect business decisions and activity; rather, the rules should attempt to utilize information already generally available in normal course of business.

80. In this regard, the requirement to gather consumer sales data should be limited, for example, to what is manageable/knowable to the business (i.e., data from the MNE's sales to a third party, regardless of whether that third party on-sells to another customer), which may not encompass data on where the end customers are ultimately located. Many of our members suggest that the indicators of customer location under the ESS VAT rules, which apply to electronically supplied services, could be used as a guide for businesses that are already subject to those rules. While these rules vary by country, it would be sensible to reference a set of rules that is already being applied by MNEs. Data points that businesses already collect/store for VAT purposes would be a feasible alternative (e.g., bill-to address, country of residence, ship-to address, payment method issuer country, etc.).

81. Without losing sight of the meaningful concerns raised in the comments above, our members propose that an MNE should be required to document its internal control framework related to revenue sourcing to demonstrate "reasonable steps" taken to obtain required information that is unavailable.

82. However, our members believe that more clarity is needed on what information should be considered "available" to an MNE. Even where information may be collected for some purpose within an MNE group, extracting and formatting that information for use in tax compliance may present significant operational challenges, which as noted above, would be compounded to the extent that privacy laws may apply. The sourcing rules should not mandate that a taxpayer use a particular piece of information that may be present somewhere in the MNE group, where the taxpayer concludes in its reasonable judgment, in

light of the constraints of its particular business, that doing so would result in unreasonable cost or a risk of violating legal obligations.

83. Similarly, our members raised questions regarding what information would be deemed adequate, for example, to demonstrate that attempts to renegotiate third-party distributor contracts were unsuccessful or where data or information were concluded to be unreliable. Some members raised concerns that there would be significant costs incurred to amend contracts to require third-party distributors to provide "information on the aggregate number and the type of products" (para. 378) and that this requirement could necessitate full renegotiation of contracts, which many of our members believe would be burdensome and costly if needed to demonstrate compliance. Business notes that, in some cases, even the third-party distributor would not have information on the end consumer's location but would, at best, only be able to provide information on its own sales to the next entity further down the supply chain. For some member companies, one entity may have hundreds of wholesalers and retailers, creating a significant obstacle to any change in contracts. We recommend, therefore, that in determining what "reasonable steps" must be taken to obtain information, a taxpayer should not be required to incur material additional costs or modify commercial arrangements in order to obtain information in the possession of a third party. If a third-party distributor were to collect and provide such data, there is also the question of who would bear the cost of IT system development, labor, and other burdens.

84. As for the market research for management reporting purposes, which is proposed as a second indicator (para. 379), in many cases the market research is carried out locally and the market research information is not always available to the ultimate parent company. We would therefore suggest adding the jurisdiction of the place of the independent distributor as a third indicator in para. 280.

Chapter 5. Amount A – tax base and segmentation

Tax base

85. In order to effectively attract and retain talent, businesses use a variety of forms of compensation. For many businesses, stock-based compensation is a critical component of designing compensation packages that will allow them to attract talent in the short term and continue to retain that talent in the medium- to long-term. In recognition of that, we note that for Pillar Two purposes, as a general matter, stock-based compensation is allowed as a deduction from the GloBE tax base computation to the extent and at the same time it is allowed for local tax purposes. Tax treatment of stock-based compensation is not respected, however, for Pillar One purposes. In our view, this approach has the potential to disadvantage companies that use equity as a component of compensation as compared with companies that use only cash compensation. This could bias companies in favor of cash compensation over stock-based compensation, which in turn could create a bias for debt financing. Increased debt financing would in turn impact earnings per share and, ultimately, market value. We would therefore recommend that the Pillar One tax base reflect treatment in the jurisdiction of the parent entity of the MNE group.

Segmentation

86. As applies equally to any aspect of the Pillar One and Pillar Two frameworks, the general view of the business community is that overly complex rules will make compliance burdensome and difficult to perform or verify. For this reason, there is widespread interest in ensuring that any approach to segmenting the Amount A tax base will be simplified to assist taxpayer compliance and limit unnecessary administrative burden, particularly when viewed against the backdrop of the policy objectives the rules are designed to achieve.

87. Segmentation should only be required in very limited and clearly articulated cases that would otherwise result in distortive impacts – for example, MNEs with significant portions of revenue that are out-of-scope of Amount A. Segmentation may lead to similarly situated MNEs (e.g., with similar sales revenue and profits) that segment their financial statements in different ways for entirely non-tax-related purposes realizing very different Amount A allocations. Financial statement disclosure, including segmentation, if any, should be driven by the intention to inform investors without the influence of potential tax outcomes.

88. While segmentation should not be a requirement, as outlined above, there should be the possibility for companies to opt for segmentation. While the principal purpose of Amount A is to achieve a reallocation of the group tax base, MNEs should have the option of calculating Amount A based on a geographically segmented basis rather than on consolidated accounts, if it so chooses.

89. Some members note that whereas geographic and underlying jurisdictional variations in profit margins will exist, they also will not be uniform across different jurisdictions within given regions, across different business models, or even across different competitors within particular sectors. Thus, whereas it may be necessary to further consider the implications and materiality of such variations in particular contexts (e.g., double-counting relief), it would be neither consistent with the simplified approach envisaged for Amount A, nor practical on a proportionate basis, to build geographic segmentation requirements into the core structure of the Amount A computation. Some members therefore would like the ability to adopt the most applicable segmentation concept for their specific business: no segmentation as the standard in case of similar profit margins between business lines and geographic regions, or business line or geographic segmentation in case of profit margin differences between the segments.

90. While our members do not have a single view on whether the hallmarks drawing on IAS 14 constitute an appropriate basis for developing a test to determine whether an MNE group is required to segment, there is general concern that this proposal would lead to significant complexity, as it could produce results that deviate from the current standard IFRS 8, which reflects how the business is run and current financial reporting, and therefore, would necessitate complex allocation keys to attribute costs and revenue to the different segments.

91. Accordingly, many members believe the starting point for any required segmentation should be to respect the IFRS 8 segmentation, rather than IAS 14 definitions, which are not audited or used for financial reporting and likely would lead to disputes with tax authorities as to what constitutes a segment.

92. Similar motives of limiting compliance burden mitigate in favor of using existing segments (under financial accounting standards) in the majority of cases for any required segmentation to compute the Amount A tax base. From the feedback we received, there is widespread consensus that financial information used to segment the Amount A tax base should be from readily available, reliable financial statements, such as published and audited global consolidated financial statements or published and audited financial statements by segment, rather than something that needs to be prepared specifically to implement the Pillar One. Financial statements of publicly listed companies, which are prepared for investor information purposes, should be assumed reliable for this reason.

93. We note that the Blueprint currently proposes existing to use segments in financial statements unless certain criteria are not met, in which case businesses would be required to prepare customized segmentation based on "segmentation hallmarks." However,

consistent with the interest in easing the compliance burden of the rules, we consider the use of hallmarks to add an additional layer of complexity and ambiguity for businesses and tax authorities.

94. Because financial statements reflect the way that business views its operations and are prepared to inform investors, not for tax purposes, a number of challenges are presented with the preparation of customized financials based on hallmarks. A full value chain analysis would need to ascertain country- or business-only financials where these are not already in place. For example, central technology and R&D costs generally are not tracked currently by country or business and attempting any allocation of such costs would be complex and require a significant resource investment from both taxpayers and tax authorities throughout the review panel process, who ultimately might contend with the allocations. Such reallocation could actually be impossible: if financial data is mapped and tracked differently in preparing accounts, it will be extraordinarily difficult to prepare reliable alternative segments. Given this, we think a more proportionate approach would be to respect that segmentation.

95. If there is a requirement for segmentation not contained in a business's financial statements, the methodology for preparing such segments should be formulaic and prescriptive (i.e., not subjective) to avoid prolonged disputes. However, devising such a methodology is likely time consuming and complex, and would likely produce results incongruent with the economics of the underlying business or businesses, meaning that a readily implementable approach would still forego any requirement for bespoke segmentation. An approach with prescriptive allocation of centralized costs would be distortive where there is disproportionate investment in businesses (e.g., a revenue or operating expense allocation driver would pull expenses to a large existing business even if the majority of spend is for a burgeoning business). Such nuances will result in additional complexity and disputes. Therefore, optionality and flexibility are key if alternative segmentation is deemed necessary.

96. Finally, businesses should have the choice, but generally not be required, to segment their profits before tax between in-scope and out-of-scope activities, unless necessary to achieve the objectives of Amount A (see, e.g., para. 445, explaining that, in certain circumstances, segmentation may be required to maintain a level playing field among taxpayers). In using consolidated accounts, looking to margins may nevertheless lead to proportionate allocation of out-of-scope activities (where the out-of-scope margin is higher than the in-scope margin) into Amount A. We believe that companies should be given the option to further segment accounts if deemed appropriate and if they can prove that such alternative segments produce a reasonable result in determining Amount A. Businesses should also have the option to base their Amount A computation based on their financial statement segments or based on more detailed segments.

97. To recap, we believe that consolidated profits should be utilized as the general default rule, with segmentation as an option for businesses to select (and only rarely mandatory) in order to ensure that tax is principally only levied on MNEs having capacity to pay (on a consolidated basis). This approach further reduces unwarranted ring-fencing of any particular business, prevents economic distortions that could arise from allocating solely domestic profits to a foreign jurisdiction, and avoids levying taxes on MNEs lacking real economic income.

Chapter 6. Amount A – loss carry-forward regime

98. Members provided extensive comments on the importance of developing clear guidance on the treatment of pre-regime losses to ensure Amount A is based on an appropriate measure of net profit and therefore only economic profits are taxed, which members recognize as particularly important to start-ups and companies heavily invested in growth, who typically generate losses when establishing their businesses. Levying corporate taxes to loss-making business hinders ability to recover from crisis, to grow and invest especially in start-ups, scale-ups and fast-growing and loss-making disruptive businesses. To the extent that loss-making business may not have capability to pay the tax, it is also fundamentally unfair. Reaching an appropriate answer on this issue takes on an increased importance in the current environment, given the impact the COVID-19 pandemic continues to have worldwide.

99. To ensure Amount A is limited to taxing only economic profits and to ensure symmetry, we believe pre-regime losses must be carried over, at minimum, during a pre-agreed, defined period (e.g., five to ten years).[7] The calculation of pre-regime loss carry-forwards reducing the Amount A allocation should be consistent with the calculation of the Amount A allocation. Non-Amount A pre-regime losses should not be able to offset Amount A income allocation. We note that some members prefer to not have any time limit on pre-regime losses in order to reflect the number of years over which expenditure is necessary on R&D to bring products (e.g., medicine) to market.

100. In addition to economic losses, we believe it is important to apply a carry-over mechanism for what the Blueprint refers to as "profit shortfalls." In our view it is a core concept of Amount A that amounts that are subject to reallocation under Amount A include only a portion of profits in excess of a threshold that effectively acts as a deemed residual return. For purposes of determining whether an MNE earns such a deemed residual profit, providing a carryover only for economic loss (i.e., the extent by which expenses exceed income) would fail to address the situation in which profits in a previous year may have been greater than zero but less than the deemed routine return.

101. For example, consider the following simple example: suppose that the profit threshold for application of Amount A is set at 10%. MNE Group A earns profits of 10% each year on identical sales revenues. MNE Group B earns 5% in two years and 20% in the third. Over the course of three years, both MNE Groups earn the same total profit. Under an approach that fails to take into account the profit shortfalls in the first two years, however, Group B would be subject to Amount A in the third year, while Group A would not. To address this disparity in treatment, the carry-forward regime for losses should be extended to include profit shortfalls. In the example above, this would permit Group B to carry forward its profit shortfall of 5% in years 1 and 2 to offset its 20% profit in year 3, which would put it into parity with Group A.

Chapter 7. Amount A – double counting issues

102. The rationale of Amount A is to allocate taxing rights to jurisdictions where taxing rights over residual profits generated in that jurisdiction are currently not allocated under the existing profit allocation rules.

103. However, members are deeply concerned that potential double counting could arise if the market jurisdictions are allocated Amount A on top of certain existing withholding tax

[7] See Appendix A for detail on a proposed "tax cap" exemption method.

liabilities or more generally when decentralized businesses who have multiple regional and local entrepreneur activities already recognize and are taxed on significant levels of profit in market jurisdictions.

104. With respect to the first potential for double counting where there are existing withholding tax liabilities, business strongly supports an approach that views withholding taxes on royalties, interest, and services as the market jurisdiction already taxing a share of residual profits. Members suggest that, in such instances, the market jurisdictions should apply a proportionate reduction in any tax on an Amount A profit allocation by the amount of the withholding tax levied in that country.

105. With respect to the second, more general concerns of double counting that could apply for decentralized businesses, members are concerned that the Blueprint currently takes too narrow an approach to the domestic exemption and marketing and distribution safe harbor that could result in double counting, which members are concerned the Blueprint's double tax relief mechanism may not be adequately designed to resolve. Business has identified that a potential mismatch arises because the Blueprint's double tax relief mechanism uses a profitability allocation key, which is inconsistent with the (source) revenue allocation key used to compute and allocate Amount A. Amount A uses a revenue allocation key for allocating the designated amount of consolidated profits (quantum) rather than a profit key, meaning that rather than measuring whether there is double counting with respect to a domestic transaction and then netting off to eliminate that double counting, the current mechanism identifies the allocated Amount A income using a revenue source key with whatever is the most profitable entity, regardless of whether that entity actually had any material role in earning profits in the market concerned. Because of this inconsistency, there is concern the double tax relief mechanism cannot be relied upon to measure and eliminate "domestic" double counting in market jurisdictions (i.e., in circumstances where the market location identified under revenue sourcing principles is the same as the resident location for the equivalent share of consolidated revenues identified under existing principles). We encourage the Inclusive Framework to clarify that all in-scope, in-country profits should be used as the amount against which this safe harbor amount is tested.

106. Members consider that this inconsistency is further exacerbated because the Constituent Entity profit figures used for the allocation will not even add up to the consolidated profit used as the basis for the Amount A computation because the total of the former does not include consolidation pack processes and adjustments, whereas the profit figure used as the basis for Amount A does. One possibility is to develop a mechanism for relieving double counting (and broader double taxation) by using a revenue key based on existing principles that is comparable to the revenue sourcing key used for Amount A allocations.

107. If sufficient profits are already attributable to the market jurisdiction, it is reasonable to assume that the allocation of Amount A is unnecessary. In this regard, the policy objective of the marketing and distribution safe harbor is understandable. However, to make this system more useful, it needs to be further elaborated and clarified. Clarification is needed on how the fixed return is related to Amount B, and how to handle cases where marketing and distribution profits calculated based on existing ALPs are less than the fixed return. The notion that the fixed return could vary by region or industry (para. 545) may undermine the efficacy and simplicity of the marketing and distribution safe harbor. Some members prefer to have a modified marketing and distribution safe harbor that does not rely on the fixed return concept for the sake of simplification.

108. In the currently proposed system, some members believe that companies with low residual profit would effectively re-allocate a substantial portion of their system profit to the selling countries due to Amounts A and B. In order to ensure a more balanced participation of companies in the new taxation system, a Marketing and Distribution Safe Harbor that is determined as a percentage of overall system profit (e.g. not more than 20% of the total profit of a company can be re-allocated) seems to be more justifiable.

Chapter 8. Amount A – identifying paying entities

109. Identifying the entities within the MNE group that bear the Amount A tax liability (the paying entities) has many complexities, and given both the complexity and newness of the proposed approach to eliminate double taxation, there is a particular need for administrative simplicity in making the system workable for both taxpayers and tax authorities. In particular, among the proposed steps, the market connection priority test requires a detailed analysis of transactions, which could make identifying paying entities extremely complex and burdensome. Focus should be made on definitional clarity to promote certainty and to minimize administrative burden. For example, definitional clarity on the term "economically significant" is needed, particularly before an activities test could be developed based on this guidance that could leverage existing transfer pricing concepts and documentation. However, it must be analyzed if such qualitative approach is necessary or using a quantitative approach only would be the preferable solution.

110. Given the inconsistencies between the use of a profitability test for identifying the paying entities contributing to the Amount A allocable tax base (as defined in para. 496) and the (source) revenue key used to allocate Amount A between jurisdictions, inconsistent identifications are liable to arise which may exacerbate double counting and other double taxation problems. Whereas the rationale behind the profitability test is to ensure paying entities have the capacity to bear the Amount A tax liability, the underlying jurisdiction-by-jurisdiction variations in actual profit margins mean that, for double tax relief purposes, Amount A will predominantly be identified as coming from the most profitable jurisdictions whereas for charging purposes it has been assumed that identical margins are made across all jurisdictions. Thus, whereas the use of a profitability test might be expected to have 'capacity to bear' advantages, its potential overriding of issues of genuine connection may produce unpredictable results. There is also a concern that the use of a profitability test indirectly introduces very detailed and unaudited Constituent Entity by Constituent Entity accounting analysis requirements (for example to separate intra-group investment or other activities from relevant operating activities) which the simplified approach of Amount A is intended to avoid. Some members also question if a profitability test adjusted for payroll and tangible assets introduces additional complexity.

111. Some members also believe that profitable entities should not receive an Amount A charge if they have no connection with the IP earning the income.

112. The objective of a profit-based allocation by paying entities might also be achieved by accepting (potentially assumed) inaccuracies and applying an even more formulaic approach. The activities test should identify entities within a group that derive residual profits from the performance of non-routine activities relating to the engagement of the group in market jurisdictions. This approach would prioritize simplicity, as it could limit the need to enter into detailed facts and circumstances functional and transactional analyses by using transfer pricing concepts to identify the entities that should bear the Amount A tax liability. For example, a two-step profitability test could be envisaged to identify entities in the group that earn residual profits, and where more than one entity is found to meet the

test, the Amount A liability would be apportioned among each entity on a pro-rata basis according to a simple allocation key. This could be supplemented with a further alternative for MNEs to have the option to designate an entity (or entities) within the group as the paying entity of last resort (para. 613).

113. However, some members (particularly those with decentralized business models) favor the market connection priority method as many operating entities would end up being classified as paying entities under a quantitative approach as they are residual profit owners. One potential way to resolve this tension is to only apply the pro-rata approach when an effective marketing and distribution profits safe harbor is applied first to determine Amount A.

114. We acknowledge that there is dissonance in simplification measures as purely formulaic processes outlined above are diametrically opposed to the objective of BEPS to allocate profits where value is created. Simplification achieves lesser administrative burdens but to the detriment of the countries creating value (i.e. those above a certain profitability threshold) by potentially reducing taxing rights and allowing a loss of M&A neutrality.

115. Some members propose other alternatives for the profitability test, such as a profit-to-revenue ratio, and suggest further exploring the proposal to identify paying entities as those that earn in excess of an agreed percentage of an MNE group's profit.

116. To eliminate double (or even multi-layer) taxation in the resident jurisdiction from Amount A, we prefer the tax exemption method to perform the reallocation, meaning the surrendering company reduces its taxable profits by the amount to be reallocated, with the market countries receiving the reallocation to increase their profits by the same amount. An exemption method-based approach in resident jurisdictions would provide simplicity whereas a credit approach would be more complex and potentially disadvantage groups unable to obtain full tax credits, which would result in double taxation. Additional double counting arises in respect of cross-border withholding taxes that would need to be addressed on a consistent basis with existing resident double-tax relief mechanisms in the counter-party resident jurisdiction. Depending on such issues of consistency, such WHT could either be dealt with by credit against local Amount A liabilities or by exemption using gross equivalents to the WHT. In each of these respects, members broadly support an agreement underpinned by a strong dispute resolution framework that requires all countries to adopt mandatory binding dispute resolution to resolve any disputes that arise.

Chapter 9. Amount B – scope and definitions

117. We support the Inclusive Framework's initiative in proposing a practical approach for tax authorities and taxpayers to deal with baseline marketing and distribution activities in a manner aligned with the arm's length principle, coupled with guidance to provide certainty in relation to the selection of the most appropriate transfer pricing method and profit level indicator (PLI).

118. Obtaining consensus regarding an appropriate transfer pricing method and PLI within the scope of Amount B will be a significant improvement in addressing transfer pricing controversy and providing dispute resolution. We see utility in having a baseline methodology and return for limited and routine marketing and distribution activities.

119. With respect to questions regarding the scope of Amount B and the definition of baseline marketing and distribution functions that would be remunerated under Amount B, we believe it is first necessary to consider the role of Amount B within the architecture of

Pillar One. The objective of Amount B is to help reduce tax disputes by providing increased certainty and a simplified approach to the transfer pricing of baseline marketing and distribution activities, meaning it must be designed to accommodate a variety of marketing and distribution operations (i.e., ranging from marketing service providers to commissionaires and LRDs and businesses that undertake additional functions (such as provision of post-sales services) but which still serve as a tested party).

120. One approach to accommodating this variety of operations, supported by some members, is to expand the definition of activities and associated transactions (such as, but not limited to, payments for royalties and services relevant to distribution) which qualify for Amount B. Some members believe this may need to be supplemented (or could even be replaced by) an approach which applies Amount B in all circumstances where the transactional net margin method ("TNMM") applies, adopting guidance which has already been endorsed to determine that threshold, and then potentially stratifying Amount B (based on functional intensity or other indicia) to accommodate the variety of marketing and distribution operations noted above, perhaps using an LRD functionally equivalent entity as a baseline.

121. Conversely, other members prefer limiting the scope of Amount B to a narrow set of factors, as doing so provides much more opportunity for successful agreement by the Inclusive Framework to give taxpayers a valuable globally consistent certainty with respect to such structures and will likely lead to a reduction in transfer pricing disputes and MAP inventories. Thus, the focus would be on the accurate delineation of the controlled transactions (i.e. functions, assets and risks) rather than using arbitrary thresholds. The Blueprint currently includes: (1) a requirement for the tested entity to take title to product, and (2) resell at least 50% of its purchases to local third parties. Removing these thresholds and focusing on an accurate delineation in substance will ensure a level playing field and avoid unintended consequences. It is important to recognize the risk differential that exists between full-scope distributors and narrow-scope distributors; this requires having any specified return set at an appropriate rate. Otherwise, there is a risk that a rate which is not materially differentiated from full-scope distributors will set an inappropriately high expectation for the returns for the many taxpayers with distributors which operate on a narrower scope.

122. If the intention of Amount A is to reallocate a portion of an MNC's residual profit to market jurisdictions, then it is important to first reach a common understanding of where the residual profit currently exists, including whether some residual profit is already allocated to the market jurisdiction. This makes Amount B more than a "nice to have" feature, because without Amount B, double-counting could result if a tax authority received an Amount A payment but then additionally argued for a higher distributor return on the basis that their market could be differentiated or had features making sales and distribution entities there special in some way. Because of this, Amount B is a critical component of the Pillar 1 architecture and should set the boundary between routine activities and those which attract residual profit. Alternatively, the proposed marketing and distribution profits safe harbor could avoid this double counting issue, because if a tax authority received a higher return to a distributor under existing transfer pricing rules, then this would reduce the Amount A allocation to the country. This highlights the critical nature of the marketing and distribution profits safe harbor to any Pillar One solution. However, we note that only some business models will benefit from the safe harbor in terms of a greater level of certainty, leaving double counting issues for many decentralised service or other business models.

123. Some members consider that if the purpose of the Amount B fixed return for marketing and distribution functions is certainty and simplification, then the potential Amount B coverage

should be sufficiently broad to minimize the likelihood of market jurisdictions asserting more revenue on the basis there are additional functions being performed in the market that are not included in the Amount B scope. To minimize this risk, these members consider that the breadth of the scope of Amount B should be dictated by the extent to which activities of marketing and distribution affiliates can be characterized as benchmarkable.[8] The scope of Amount B could be informed by reference to the threshold for using the TNMM, which is used where routine sales and marketing activities are performed and therefore is appropriately the boundary between routine activities and those which attract residual profit and central to the operation of Amount A. However, other members believe that having a broader scope of benchmarked activities will not lessen disputes, with controversy simply shifting from disagreement over arm's length pricing to arguments over whether Amount B applies or not to a given business activity.

124. If an activity is routine, by definition, it does not already contain any element of residual profit. Conversely, a marketing and distribution affiliate would not serve as a tested party if the affiliate undertakes functions, owns assets or bears risks that would represent such a unique contribution to an MNE's overall profits that the TNMM is not deemed an appropriate method. Instead, remunerating these activities would require a different method that results in the affiliate's participation in the residual profit or loss. Using this logic, members supporting a broad scope believe that Amount B should apply in all cases where the TNMM is applied for marketing and distribution companies, which, as discussed, represents the boundary between routine activities and the residual profit central to the operation of Amount A.

125. If the scope of Amount B is defined in a way to increase certainty, with an acceptable quantum, businesses will likely aim for their activities to fall within the criteria for appropriate functional benchmarking to be performed on those activities. Threshold issues, such as the extent of a sales and marketing affiliate's freedom to set prices or undertake marketing activity on its own account, are the same that exist to differentiate application of the TNMM or another appropriate transfer pricing method.

126. Business sees a clear benefit to narrowing the criteria to be tested and more particularly, to specify that, once met, the criteria will enable a business to apply a pre-agreed baseline level of remuneration. In this regard, it would be helpful to include an overarching statement, drawing on Chapter 1 and Chapter 3 of the Blueprint, that recognizes the key test is whether a sales and marketing affiliate undertakes functions, owns assets or bears risks that give it sufficient bargaining power to capture economic rents, or if not, the presumption is that it can serve as a tested party.

127. Some members believe that MNEs should be allowed to rebut the fixed return through the use of CUPs, provided that only the MNE has the right to rebut (and they bear the burden of proof). If an arrangement falls in the scope of Amount B, a taxpayer should have certainty in relying on Amount B. If the tax authority is allowed to propose another transfer pricing method and rebut the Amount B position, then there is no certainty for the taxpayer and therefore no utility in establishing Amount B in the first place. The flexibility to rebut an Amount B position might undermine the purpose of Amount B and increase disputes given disagreement over the applicability of Amount B and the arm's length principle.

[8] Some members note that the scope of Amount B could be informed by reference to the threshold for using the TNMM, which is used where routine sales and marketing activities are performed and therefore is appropriately the boundary between routine activities and those which attract residual profit and central to the operation of Amount A.

128. Other members are concerned that as the Pillar One Blueprint currently stands, the purpose and effect of the Amount B rules are unclear enough that controversy is inevitable. They are concerned that an immediate implementation based on a broad scope would instead either increase the frequency of controversy, result in a significant number of case results deviating significantly from arm's length, or both. In general, arm's-length outcomes require a detailed examination of facts under the comparability standard. In contrast, the Amount B approach, as described in the Blueprint, requires reaching agreement on a generalized basis on arm's length outcomes for a list of specified activities, with variation considered only by industry and geography. A broad scope for Amount B, to include for example limited function marketing and sales support entities, would require substantial variation in the quantum of Amount B, including criteria for choosing among alternative profit level indicators, for the variety of fact patterns covered, in order to align with the requirement to produce approximate arm's length results. These members therefore do not support a broad scope for Amount B, at least as an initial matter.

129. These members believe that it is appropriate instead to start with a narrow scope and high materiality thresholds, and evaluate the need or appropriateness of expanding scope only after obtaining experience with how Amount B would operate in practice. This approach would have the additional benefit of taking some time pressure off of the need to arrive at standard fixed returns for a broader and more varied scope of activities. Consistent with this view, these members also believe that multifunctional entities should not initially be in scope. This issue could also be revisited after a few years of actual experience with Amount B.

130. If the introduction of Amount B is inevitable, the scope of local subsidiaries subject to the new rules could be limited in light of proportionality. Also, it could be clarified that only if there is a strong correlation between sales and the functions performed by the entity performing the baseline marketing and sales activities, then Amount B applies to that entity. In other words, an entity that uses the Berry ratio could be excluded. The level of return on sales could be capped at a very low level, and the total profit allocated to market countries capped. Under special circumstances, such as COVID-19, the LRD in the market jurisdictions could be required to bear the losses. As a result, those members consider that it would be more appropriate instead to start with a narrow scope and evaluate the need or appropriateness of expanding scope after experience with how Amount B actually operates in practice.

Chapter 10. Amount B – profit level indicator

131. If the scope of Amount B is relatively narrow, a fixed operating profit margin measured as a return on sales, which has become the default profit level indicator for routine functional entities in practice, would have the most likelihood of success. A broad scope, especially one that includes entities performing marketing and sales support functions without taking title, but also one that does not make sufficient allowances for buy/sell entities with very low functional intensity (i.e., value-adding activity) relative to sales in comparison to available comparables, will require consideration of alternative PLIs and creation of rules governing the selection of the appropriate PLI for each case. A ratio of gross margin to operating expenses (Berry ratio) may create substantially less distortion relative to arm's length in cases of low functional intensity relative to comparables. For low risk, routine sales and marketing support services providers, a cost-plus PLI may be more appropriate.

132. Regardless of scope, it is critical to distinctly differentiate the returns for limited risk companies from independent, at-risk sales, marketing, and distribution operations. Given

that the available comparables are likely to be composed of such companies, further consideration might be given to making economic adjustments to account for the difference in risk and/or functional profile.[9]

133. The OECD Transfer Pricing guidelines reference capital adjustments, which are commonly applied in practice to account for different amounts of working capital in limited risk companies relative to the comparables set. These adjustments assume that an investment in inventory holds equivalent risk (and therefore deserves an equivalent return to) an investment in a low-risk financial instrument. However, this potentially underestimates the importance of the risk and potential returns for working capital.

134. The Amount B benchmarking process should take this into consideration. Even though Amount A applies at a profit before tax ("PBT") level and consistency is desirable, for pragmatic reasons, we believe it would be more appropriate to apply Amount B at an earnings before interest and tax ("EBIT") level, which is the level at which most businesses coordinate the results of their low risk and function entities, leaving financing considerations to be dealt with separately.

135. There are many reasons why it makes sense to adopt this approach, the most important perhaps being that the way a business is financed bears no relation to the return from its operating activities. To set a PBT target for a company without any debt would inappropriately reduce its operating margin based simply on the fact that comparables are likely to bear some element of interest. Similarly, if a business is managing to a PBT level and an adjustment is required to hit the desired margin, it would not be clear whether the adjustment should be to interest or to the non-financial transactions entered into by the business. Amongst other things, this could have customs duty ramifications. The only way to manage this would be to refer to the EBIT margin of the comparables, which ultimately would create a thin-cap style rule based on the interest levels in the comparables set, which would need to be universally agreed to.

136. In terms of whether quantitative indicators or thresholds could be used to gauge whether entities fall within the scope of Amount B, consensus is that quantitative indicators may have a potential role to play. However, there is some concern in how quantitative indicators would be defined, primarily because qualitative factors seem more useful to the primary scope-related question of whether an affiliate participates in and/or controls aspects of residual profit (i.e., is not capable of being a tested party), which is based on a series of facts about whether the business owns intangibles or makes other unique contributions. The question of whether a company's risk is comparatively 'limited' remains dependent on a qualitative assessment, such as combination of contractual and functional characteristics. The use of quantitative factors could create an added compliance burden of gauging, on an annual basis, whether the threshold had been met, particularly if it had with respect to certain operations but not others.

[9] It is important to consider the potential impact of Amount B on low margin businesses. For example, an MNE with a structural consolidated system profit of 3% which would need to allocate a 3% RoS to the market under Amount B would have no profits left to remunerate its other activities such as manufacturing, etc. This would lead to double taxation for low margin businesses. If the system profit in the example were 2%, the Amount B allocation of 3% exceeds the total profit available within the group and leads to the creation of taxing rights in addition to the double taxation linked to upstream activities. As such, the level of profits allocated through Amount B should to some degree consider the system profit of the MNE to avoid such situations from arising.

137. If the sales and marketing segment within a multifunctional entity that carries on other activities meets the definitional criteria for applying Amount B, then Amount B should apply, with the issues noted above (with respect to the use of the TNMM as a general threshold between routine activities and those which attract residual profit) still present, but only with respect to the specific segment. The rest (e.g., non-sales and marketing) of the entity's activities are nonetheless still relevant to the residual profit analysis and the determination of who pays Amount A, with the suggestion that the TNMM be used as a general threshold between residual and non-residual activities, regardless of the function which is being benchmarked.[10]

138. Some members suggest that the TNMM threshold based-approach could be applied to a broader scope of sales and marketing operations, with the added benefit of reducing disputes (especially as compared to the narrow form currently envisaged in the Blueprint, which is prescriptive and will require much more effort to demonstrate whether a threshold has been met or not). However, there still is concern among some members that if the scope of Amount B remains narrow, market jurisdictions will conclude the existence of additional functions and assert additional revenue, which will result in more, rather than fewer disputes. This could be handled by having a reference point for the LRD functional entity which could be subject to modest functional intensity related adjustments up or down to reflect higher or lower intensity Amount B qualifying entities.

139. Other members believe that the added complexity required by a broad scope in selection and adjustment of PLIs and other aspects of Amount B will create a situation where existing disputes are simply replicated in the new framework, or alternatively where in a significant number of cases the results will substantially deviate from arm's length, resulting in double taxation of disputes under existing tax treaties in either situation.

140. Business recognizes that, regardless of the definition adopted, the effectiveness of dispute prevention or resolution ultimately will rest primarily on widespread acceptance of the scope and the underlying benchmarking analysis used to gauge the appropriate return under Amount B. Undertaking a comparables search and then agreeing on the resulting set takes substantial time and effort, meaning it could be preferred to agree to a common sales and marketing distribution return to simplify transfer pricing compliance and focus resources towards disputes over more fundamental areas, such as what enables a particular MNC to earn residual profit or what moors this residual profit to a particular location. Current experience suggests it might be unrealistic to expect this kind of agreement can be reached, but it is worth trying.

141. In this regard, a starting point might be to derive a common agreement as to when it is appropriate for a sales and marketing affiliate to apply the TNMM and to then consolidate the various accepted comparables search strategies, which MNEs and tax authorities could use. Business notes that, once established, the marketing and distribution return under Amount B should remain relatively constant (i.e., for a five-year period) without imposing additional time and resource costs associated with revisiting pricing on a more frequent basis provided there is no material change in the function and risk profile. Some members recommend performing a fresh study every three to five years with an annual roll forward of financial results of the selected comparables. Defining an upfront timeframe and process for price setting will be important to ensure administrative certainty. While tax authorities might surrender a degree of freedom to make subjective assessments, in return, both tax

[10] Some members note that this only works if a CUP is not present.

authorities and businesses alike would benefit from increased certainty and lower compliance costs inherent in a broadly-based Amount B.

142. While many MNCs undertake regional comparables searches, it is common that the results are sufficiently convergent to apply a global RoS in applying the TNMM. However, an approach differentiated by industry or region will ultimately result in the need for multiple annual reference sets, which adds administrative complexity. Distribution channels do sometimes differ markedly by territory, but where marketing and distribution companies cannot exert bargaining power, their returns are largely consistent.

143. Because of this, members supporting a broad approach consider it preferable to apply a universal return, perhaps graduated based on functional intensity. To be fit for purpose, the Amount B scope should cover the vast majority of local country affiliates, which is also important for an effective marketing and distribution safe harbor. A proposed first step might be for Working Party 6 to undertake a global search for independent marketing and distribution companies, using mutually acceptable search criteria, and then to assess the extent that the results differ materially by industry or by geography(y point of reference, KPMG's fact-based economic study found that the median return for limited risk and value-added marketing and distribution activities fell within a narrow band regardless of industry, geography or profitability and did not increase as a percentage of total system profit as profitability increased).

144. However, some members point out that in a number of countries, the RoS of the distribution entity is also relevant from a customs perspective as it determines the import value of goods (under either the "transaction value method" or the "deductive value method" set forth under the WTO Agreement). If the RoS of the distribution entity is not strictly speaking at arm's length because of the use of a too broad benchmark, it can no longer form an acceptable basis for the determination of import values. This may have far-reaching consequences (from an increase in customs disputes to changes in the customs duties revenue) which should be part of the impact assessment of Pillar One.

Chapter 11. Early Tax Certainty Process – Amount A

145. The early certainty process set out in Chapter 9 of the Pillar One Blueprint is a heroic start to designing a process, but perhaps the biggest key challenge will be the ability to deliver the desired outcome of tax certainty to all those MNES that request it and to do so within anything approaching an acceptable timeframe for business and without creating significant resource costs for both the tax administrations and MNEs involved in the process. Based on the estimate of the potential number of businesses subject to Amount A (which is estimated in the Economic Impact Assessment as 27,500 MNEs, but of course will depend on the thresholds applied), having even a fraction of those companies seek early certainty for Amount A issues risks overwhelming the resource requirements of many tax administrations, particularly if they are often the lead tax administration for the MNE, such as the Unites States or Switzerland. Meeting this demand might require deploying significant resource from other tax administration work, including mainstream tax and transfer pricing compliance and dispute resolution work. Restricting the numbers however would go against the aim of the Blueprint, which sees early certainty as an integral part of the solution. So there is a critical mass of complexity involved in designing a new system in this regard.

146. While the certainty steps proposed in the Blueprint are laudable in concept, they are of such complexity and require a speed of response and cooperation from tax administrations that is likely unrealistic (or at least is not observed today when looking at the time taken for completing MAPs and APAs).

147. Requiring the outcome to be binding on all participating Pillar One jurisdictions will strengthen the intended certainty element and greatly limit the possibility of numerous, extended disputes over Amount A components and Amount B scope among governments.

Timelines

148. To reiterate a general comment made earlier, we believe consideration could be given to the possibility for a phased approach on this issue, beginning with the largest MNEs, as this would reduce workload volume while still covering a large percentage of the income allocation base (so long as there is no discrimination against any particular industry or country, with the result being confirmed by an economic impact analysis of such a phased approach). In addition, larger MNEs have more experience preparing documentation of the sort needed for the anticipated processes.

149. While the intent behind the early certainty process is appreciated, a significant concern is that the complexity involved will necessitate significant periods of time to resolve the issues under review. This could in turn clash with domestic tax processes or aspects of Amount A taxation that would require tax years remain “open” or subject to adjustment beyond local due dates.

150. The time taken for achieving early certainty must be of short enough duration to yield tangible benefits before tax reporting obligations kick in. Therefore, some members are concerned that a multi-year process for reviewing and determining critical Amount A issues, even if ultimately successful in providing a binding outcome, will come too late to provide meaningful dispute prevention. We encourage the Inclusive Framework to think creatively in collapsing the certainty timeline to yield more beneficial results based on a review of existing pre-filing ruling programs currently in place.

151. There are numerous potential avenues for reaching early certainty. For example, perhaps the review and determination panels should be collapsed into a single proceeding with binding force to remove lengthy back-and-forth procedures. Another suggestion would be to adopt a “fast track” or similar simplified process for MNEs that clearly stay below the relevant PBT profit threshold. One potential option to enhance the certainty process is a peer review mechanism of home jurisdictions to assess certainty procedures.

152. The early certainty process should also apply for more than one year, giving the MNE an assurance that if it followed the basis of calculation for Amount A that was agreed for the first year (or there were no changes in scope), this would be acceptable to all affected tax administrations for a set amount of time (for example, 3 to 5 years subject to an agreed set of critical assumptions, much like an APA).

Process components

153. Certainty should be achieved both in determining whether a MNE is in-scope for Amount A and all consequent determinations (such as tax base, segmentation, revenue sourcing, and allocation). While many members believe that a definitive list of industries in-scope for Amount A is a useful tool, at a minimum some binding review process on scope is needed.

154. The certainty process should consider suspension of any payment of Amount A to the affected tax administrations until the process to achieve early certainty has finished, either successfully or has reached a point where no further process is available (e.g., if the MNE has withdrawn its request for early certainty).

155. We would encourage further thought to be given to the rights provided an MNE’s lead tax administration to participate in the determination panel under rules that do not allow other countries to override the lead tax authority by majority vote. Instead, the framework might

require a super majority vote or consensus with limitations on the ability of countries with a direct and material interest to object and stall the panels' efforts. Any resolution process that allows aggressive market jurisdictions without a direct and material interest to object or override the lead tax authority will result in additional disputes and controversies which will take years to resolve (if ever).

156. In determining the activity test to find out which group entities bear Amount A tax liability, there could be transfer pricing adjustments leading to reclassification of a group entity which would implicate the use of the arm's length principle in Article 9, leading to reallocation of taxable income and double taxation. Therefore, it is important to understand how any new instrument to implement Amount A will interact with the OECD Model Convention (including Articles 7, 9, and 25).

157. The proposal to require a coordinating entity to provide an agreement signed by all entities in the MNE group undertaking residual profit activities appears unduly burdensome in practice. Consideration should be given to permitting UPE confirmation, as the proposed agreement may have uncertain legality in some jurisdictions.

158. In practice, it may be challenging to decide the criteria used for determining which tax administrations or outside experts should participate on a particular review panel. We encourage the Inclusive Framework to err on the side of taxpayer confidentiality, simplicity, and administrability in settling on the composition and selection of panel participants, which should be limited to jurisdictions with a direct and material interest while allowing other jurisdictions to be informed.

Transparency, Participation, and Taxpayer Rights

159. It is important to further articulate that the Amount A review and determination panels must be conducted under confidentiality rules and ensure that information can't be used for other purposes. In order to enhance transparency of this process, we suggest that outcomes from a review or determination panel be made public on an anonymized basis. Given the expected significant number of cases on Amount A issues from which will arise, transparency will help provide consistency and greater clarity.

160. A concern arises from the notion that tax administrations involved in a review panel for Amount A may request a detailed description of the methodology and controls applied by the MNE group in order to ensure the integrity of its data and processes. This requirement would go beyond what is provided in a normal tax return and even information provided in a tax audit or APA. This item should be further developed to ensure that it is less burdensome and limited to requests for relevant information from panel participants with a direct and material interest.

161. The envisioned certainty process should consider meaningful participation by an MNE where appropriate. The Blueprint currently seems to contemplate the MNE only having limited engagement by attending a conference call or a face to face meeting in rare circumstances. Business will however be discouraged from entering a process over which they feel they have limited visibility and in which they are not allowed to participate. If there is a separate process to determine whether an MNE group is within scope of Amount A, it could be structured so that a taxpayer could choose the topics to be covered (similar to an APA).

162. In the contemplated panel structure, a taxpayer is not permitted to request a review panel if the lead tax administration does not seek one, and is not permitted to request a determination panel if it disagrees with the review panel outcome. In both cases, the taxpayer should be afforded the right to access the panel process, otherwise they are only

left with domestic remedies, which in the case of Amount A reallocations could involve a significant number of jurisdictions. A limitation of taxpayer rights in the context of binding dispute resolution proceedings is also counter to rights afforded in other contexts (like the EU Dispute Resolution Directive). This highlights the need for a binding international tax resolution panel (i.e., a standing committee).

UPE Jurisdiction as Coordinating Entity

163. The designation of the tax administration of the MNE's ultimate parent as the coordinating entity during any dispute prevention procedures under Pillar One is supported by most members as the most appropriate and efficient mechanism. However, a few members note that there are circumstances – such as dual-listed businesses and businesses where the UPE is a private company (perhaps under family ownership) – where there may need to be an opportunity for a MNE to have a role in deciding which country will be the lead tax administration. In addition, some companies that operate multiple businesses have different headquarters for each business segment in various jurisdictions. In such cases, it is desirable to ensure that the headquarter for each business segment can be a coordinating entity instead of the ultimate parent entity.

164. As many issues as possible should be shifted to the UPE coordinating entity that do not require much subjective judgment – like scope and segmentation – with clear guidance that could reduce the adjudicatory burden on tax authorities.

Chapter 12. Tax Certainty – Beyond Amount A

165. Broadening the reach of tax certainty measures beyond Amount A would be a welcome step by the Inclusive Framework. Already, business and governments spend too much time and limited resources on disputes related to transfer pricing, permanent establishment, and other issues. However, given the diverse views among Inclusive Framework members on this topic, perhaps a first step should be conducting a peer review on certainty processes to identify country or region-specific issues leading to more tailored recommendations to further improve tax certainty in practice.

166. As regards in-scope taxpayers, the offer of access to mandatory and binding resolution in respect of all transfer pricing and permanent establishment disputes arising in relation to any of their constituent entities is suggested as a quid pro quo for the compliance burden of applying the new rules for Amount A. In reality however, this may not be much of a benefit given that many of the countries that are likely to be market jurisdictions have already signed up to mandatory binding arbitration through the MLI and, if they have not, they are unlikely to accept this proposal given their concerns on arbitration undermining their sovereignty as a nation state. It is possible that some countries like the US, which has not signed the MLI, might be willing to participate in this element, especially given that a large proportion of Amount A taxpayers will be US MNEs, but this would still need US Senate approval.

167. There is currently very limited experience of arbitration as a means of resolving transfer pricing disputes. Its value so far has been in its deterrence as most Competent Authorities do not wish to hand over their work to an independent panel who will judge their arguments and which they may lose. Where cases have gone to arbitration, the binding nature of the outcome has been an important element of the process. It is hard to see that without this element arbitration is anywhere near as effective an instrument and could be seen as little more than an advisory panel. It is also debatable whether the addition of peer review or statistical reporting will have significant impact given the time these reports take to compile and the limited amount of data that will be available.

168. We suggest better scrutiny of cases before they reach the Competent Authority as once a case has reached the point where MAP is available to a taxpayer, it is often too late for the Competent Authority to do anything other than argue for the adjustments that has been made. However, there is strong evidence that early consultation with the Competent Authority by field audit teams before an adjustment is finalized prevents disputes going into MAP. This also has the effect of significantly speeding up the resolution of all MAP cases by concentrating Competent Authority time on more material areas of dispute.

169. In terms of training and guidance, the OECD should consider including practical guidance and the development of specialist training on marketing and distribution cases given their prominence in all transfer pricing disputes. The current Transfer Pricing Guidelines provide considerable guidance on intellectual property but very limited guidance of a practical nature on other aspects of the value chain. Marketing and distribution entities are the 'low hanging fruit' for many tax administrations and studies show that these disputes form a large share of all the transfer pricing disputes occurring today.

170. On the question of whether to have a separate process to determine if a MNE group is in-scope of Amount A, members note that this process could be helpful in early years following implementation of Pillar One, but this might lessen over time, as well as create delays for other aspects of a certainty process. Thus, after a reasonable implementation period, a fast-track or simplified early procedure could be more beneficial for MNEs that clearly stay below the relevant PBT profit threshold.

171. Mandatory binding dispute resolution is needed to ensure that MAP works properly by incentivizing timely government consideration and lead to negotiation of reasonable positions on both sides of the transactions at the outset. As we have shared in previous comments, the use of mandatory binding arbitration is essential to helping MAP function. Specific adjustments that would further improve the MAP process and make it more useful in the Pillar One arena include having uniform procedures in order to prevent countries from avoiding MAP obligations and allowing taxpayers direct participation once a case has been initiated.

172. Treating mandatory binding dispute resolution as a "last resort" for in-scope taxpayers could significantly delay access to this tool, reducing its effectiveness. One possible approach is making it available earlier in the dispute resolution process at the request of the in-scope MNE.

173. Requiring developing countries to first follow a multi-year MAP process will likely leave few resources available for mandatory binding dispute resolution.

174. Given the linkage between Amount A and Amount B there is a strong argument for applying the same early certainty mechanisms for Amount A to Amount B as well.

175. It would be useful for any extended certainty process to address withholding taxes as these also often involve split taxing rights.

176. Further consideration should be given to how the promising nature of ICAP can be transformed into a more scalable practice to take on robust work regarding profit allocation issues, as well as to increase certainty for ICAP outcomes by limiting the ability for a tax authority to open an audit into issues considered and agreed within ICAP. The inevitable disagreements that will occur between Inclusive Framework adopters of Pillar One demands a robust process to mediate these disputes with finality and timeliness.

PILLAR TWO BLUEPRINT – Technical Comments

177. As Pillar Two would be implemented on an optional basis by jurisdictions, it is critical to ensure that domestic measures by implementing countries do not result in a patchwork of rules. This highlights the need for any final framework to clearly articulate key parameters, and the extent to which any deviations are allowed, such departures should be based on articulated principles.

178. There are a number of regimes apart from the U.S. GILTI rules that touch on aspects of the Pillar Two regime, such as Germany's license barrier rule, the taxation of IP offshore receipts in the United Kingdom, an undertaxed payment rule in Mexico, and a withholding tax on interest/royalty payments to low-tax jurisdictions in the Netherlands, to name just a few. Insofar as existing UTPRs are concerned, the Pillar Two framework should ensure that the operation of these existing rules is limited and will not apply to payments made to entities that are subject to an income inclusion rule (IIR). Indeed, where an existing national regime already provides sufficient protection against very low overall effective tax rates, that regime should be considered acceptable and prevent application of Pillar Two in its entirety for parented entities.

179. It is worth noting that the stated aim of Pillar Two is to address remaining BEPS issues, yet a global minimum level of tax was not a part of the BEPS initiative and the foundations on which Pillar Two is built are not clear. As we stated in our letter to the previous Pillar Two consultation, it seems premature to address a perceived BEPS issue when the full reforming effect of recently adopted measures has yet to be measured. It is also important to balance such BEPS concerns against the significant compliance burdens and risks of over-taxing already high-taxed foreign income that are inherent in an income inclusion regime (or, for that matter, any element of Pillar Two). Without a clear expression of the principles underlying the Pillar Two framework, it is difficult to build business support. Nevertheless, we endeavor to be constructive in sharing our views on the many technical components of the aggregated architecture, including the questions outlined in the Public Consultation Document.

180. Attention must also be given to the needed synergy between Pillar One and Pillar Two in administrative matters and taxpayer compliance. There seems to be less sensitivity in the Pillar Two Blueprint to building out a framework tied to existing taxpayer data collection, which if ignored, will lead to new onerous provisions that saddle business with high compliance costs.

Chapter 1. GILTI Co-existence

181. Although many members understand and agree with ensuring close alignment for GloBE with GILTI where possible, the OECD must prevent any perceived favoritism. Any frameworks adopted by jurisdictions which meet the same goals should be accepted as an equivalent IIR.

182. Indeed, a number of members are concerned that despite any similar intent underlying the GloBE and GILTI frameworks, material practical differences between the two regimes will make it impossible to not burden non-U.S. companies who will be subject to compliance activities under both. For example, competitive concerns are implicated in many situations where a non-U.S. MNE may be subject to Pillar Two in its UPE jurisdiction and yet have to comply with GILTI for intermediate U.S. holding companies. Some member companies believe that less competitive distortion would occur if a GILTI co-existence mechanism was limited to U.S. direct subsidiaries. There is also likely complexity to be found in GILTI co-

existence where the two regimes touch/overlap (such as with regard to partnerships, joint ventures, or intercompany charges under the UTPR).

183. For U.S. based multinationals, GILTI compliance should result in an exemption from the entire GloBE regime for all non-US subsidiaries (including joint ventures). The Blueprint fails to clarify whether a U.S.-based MNE group might yet be subject to top-up taxation under the GloBE framework via application of UTPR if U.S. ETR is below the minimum rate for some reason. Given the policy intent behind GILTI co-existence, it is appropriate to treat the GILTI rules as a qualifying substitute for the GloBE regime as a whole, resulting in a complete exemption from the GloBE system (both IIR and UTPR) for U.S. based multinationals (subject to equal treatment for other similarly consistent regimes, as noted above). Consistent with the top-down approach, this means GILTI should be switched off for intermediate U.S. entities if the non-U.S. parent has an IIR in order to simplify coordination and ensure a level playing field.

184. Many U.S. members believe that interactions between GILTI and GloBE should be expanded to include interactions between BEAT and GloBE, such that if the U.S. does not limit the operation of the BEAT in respect of payments to entities that are subject to an IIR, it should be clarified that BEAT is a covered tax for GloBE purposes. If GILTI is not switched off for intermediate U.S. entities, the rules will also need to coordinate excess charges to ensure a level playing field for MNE groups with intermediate U.S. entities.

185. Some members believe that additional administrative burdens could be removed from the GloBE framework by a switch to GILTI's global blending. Adjusting GloBE rules to follow the GILTI framework in this respect would also have the advantage that the GloBE rules can be based on an existing set of rules, taking into account experiences of GILTI in practice. Further, global blending provides an administrable solution to managing timing and permanent differences. Operating on the basis of global blending might also reduce any risk of GloBE being challenged under EU law. A smaller group of members further suggest that the many identified differences between GILTI and GloBE demonstrate that the two systems should be fully harmonized in order to have Pillar Two create a global level playing field rather than permit potential competitive concerns.

186. A segment of members (including most US-headquartered MNEs) believes that deeming GILTI as a compliant regime for U.S. based multinationals should encompass not just the IIR, but operate for all of Pillar Two (including the UTPR and STTR elements). This springs from comments in the Blueprint that GILTI is a more onerous provision in certain respects and so a comprehensive exception for GILTI taxpayers is consistent with the Pillar Two objectives. Regardless of the extent to which GILTI is deemed compliant with Pillar Two, there are unanswered technical details that must be resolved, such as the circumstances which would cause GILTI to cease to be a compliant regime. For example, would minor amendments to the GILTI regime invalidate the exemption, or are there certain features of GILTI that must be retained to maintain the exemption?

Chapter 2. Scope of GloBE rules

187. Some members note that the scope of the IIR includes unconsolidated subsidiaries excluded due to materiality grounds, but the inclusion of these subsidiaries could result in an additional administrative burden. Consequently, these members do not believe that the scope of GloBE should be strictly aligned with that of CbCR.

188. A segment of members believe that international shipping should be exempted from the GloBE rule. As pointed out in the Blueprint (para. 111), alternative tax regimes, such as the

tonnage tax, have been introduced in many countries, and the application of the GloBE rule could cause problems in the framework and policy decisions of each country with respect to international shipping. Some members note that any approach should apply equally to profits from shipping for third parties as well as shipping businesses within an MNE group.

Chapter 3. Calculating ETR

189. The primary policy objective of Pillar Two is to ensure a minimum tax applies to all MNE profits when, at a jurisdictional level, the effective tax rate is below a certain threshold. However, it is important that Pillar Two is implemented in a form that applies to truly undertaxed profits without leading to double taxation. As currently proposed, Pillar Two does not adequately address timing differences. This will result in excessive taxation and double taxation as GloBE tax will apply to economic profits that that have been taxed above the minimum tax threshold.

190. Comparison of accounting profit to cash tax to determine the ETR creates a fundamental problem, particularly for industries with large timing differences. Covered Taxes is broadly cash tax paid based on taxable profit in line with local tax laws. The GloBE tax base is accounting profit before tax based on international accounting standards. For many industries, in particular capital-intensive industries, taxable profits materially differ from accounting profits due to differences in the timing of recognition of income and expenses (including depreciation) between local tax laws and international accounting standards.

191. In its current approach to this issue, the Blueprint has chosen to not use deferred tax accounting as the default methodology to address timing differences, which means there is limited use of and reliance on either the MNEs' externally audited consolidated financial accounting data or the extensive deferred tax conceptual framework which has been developed over many decades to help address substantially the same ETR measurement issues in other areas.

192. As the level of judgement exercised in determining accounting profit under the accounting standards may be viewed as exceeding any level of judgement relevant to deferred tax accounting, it is not clear why that level of judgement is acceptable in determination of the denominator (i.e., accounting profit), but not the numerator.

193. It would be inaccurate to reject deferred tax accounting out of hand on the basis that it relies on the taxpayer's estimate of future tax liability. International accounting standards (i.e., IAS 12 or equivalents) govern deferred tax accounting and dictate its computation in all but a small number of circumstances, meaning the overwhelming majority of deferred tax accounting is mechanical, with no judgment involved. Any judgment arises with respect to "estimated" items, such as uncertain tax positions, assessment of recognition and recoverability (i.e., valuation) of deferred tax assets and the recognition of deferred tax on future distribution of profits by subsidiaries. These limited items can be isolated, with agreed adjustments made to address any related policy concerns, while still making use of the remaining externally audited consolidated financial accounting data, which comprises all non-judgmental items that affect the effective tax burden of an MNE but risk being ignored under the Blueprint proposal. In this respect, some members note that rejection of deferred tax accounting on the grounds that limited judgment may be exercised in discrete circumstances would seem inconsistent with acceptance of the significant amount of judgement involved in determining accounting profit.

194. Indeed, some members believe there are several major benefits of using deferred tax accounting to calculate the numerator. The first and most obvious one is reduced

administration, since the numbers are already available for accounting purposes. A second benefit is reliability, since the financial statements are mostly subject to audit. A third one is that the tax expense would match the income on which it is calculated, since all temporary differences would be captured and not only the ones outlined in the Blueprint. Other temporary differences, which may be material in amounts and thereby have a significant effect on the annual ETR are, for example, pension provisions, inventory valuation, certain other types of provisions and, not the least, the difference between IFRS and statutory/tax treatment of R&D expenses and developed intangibles, which may be activated on the balance sheet and amortized under IFRS while immediately expensed for local GAAP/tax purposes. Furthermore, deferred tax accounting captures the effects of tax loss carry-forwards.

195. This group of members notes that adopting deferred tax accounting to determine the ETR will eliminate the need for complex transitional rules related to pre-regime losses. It will also reduce the need to rely on complex carry-forward and credit rules. In this regard, it is important to recognize that the transitional rules to be adopted will depend on the solution that is taken up to address timing differences within the GloBE rules (otherwise there will be double counting of income or expenses, or income and expenses that are missed altogether). Thus, these members believe that adopting deferred tax within the GloBE rules ensures a coherent solution pre- and post-regime.

Tax Base

196. The Blueprint provides that intercompany items can be excluded to the extent the transaction is between group members in the same jurisdiction. We suggest clarification be given that this option is only for the MNE to make and not for jurisdictions to choose, as the latter would lead to significant complexity if countries were choosing different reporting options.

197. While the Blueprint recognizes the need to adjust for Pillar One outcomes, it does not mention outcomes of the other BEPS actions. For example, if an intercompany transaction between group members in different jurisdictions gives rise to income that is not taxable in the recipient country and the paying country refuses a deduction on the basis of the "D/NI" rule of BEPS Action 2, then the policy concern underlying Pillar Two has already been addressed and MNEs should be allowed to exclude such income when determining the GloBE tax base of either country.

Timing Differences

198. As noted above, business agrees that there needs to be a comprehensive solution to address timing differences, especially those related to tangible capital assets. With respect to capital-related timing differences, the Blueprint proposes two solutions: either to treat deferred tax liability as a covered tax with respect to depreciable property, or to compute the GloBE tax base by applying local tax depreciation conventions to the accounting base of assets. Given the materiality of capital related timing differences across all industries, Business at OECD members agree that the GloBE rules need to provide a solution to address timing differences and reduce the amount of work any transition, credit, or carry-forward rules would require. This is not only true for tangible property but for intangible property as well which, although not addressed by the Blueprint, may also involve significant investment or R&D that is recovered throughout the business cycle.

199. However, as an initial comment, some members believe it is important to address the premise of the Blueprint in choosing to use financial statements as the basis for calculating ETR. As we have previously noted, the particular nature of financial statements is ill-suited to

serve as the foundation for a complex tax calculation. It may be seen as a more convenient administrative method, but the purpose of financial statements is not to determine tax policy or tax base but rather to provide neutral information for investors and creditors for the purpose of considering contributions of capital. Other members consider externally audited financial statements to be the most effective starting point.

200. Nevertheless, we will attempt to provide constructive comments on the current direction chosen by the Inclusive Framework on this matter. There is widespread consensus among our members that the premise of the carry-forward system is impractical for the IIR, as it is likely impossible to expect all jurisdictions to honor an unlimited carry-forward, and they would instead likely enact varying degrees of time limits. There is no question that absent an unlimited carry-forward system (including a carry-back) along with robust mechanisms that enables refunds, companies will be subject to double taxation. Anything short of a system which truly enables monetization of top-up taxes paid as a consequence of timing differences will fail to honor the length of investment cycles that businesses face, particularly in capital intensive industries.[11] A concurrent concern is that tracking unlimited carry-forwards will require significant complexity that may diminish (or even erase) any benefit achieved due to compliance burdens for some companies.

201. Therefore, we believe the Inclusive Framework should give strong consideration generally to a system that relies on deferred tax accounting principles because of its conceptual ability to provide a more complete answer by considering all temporary differences instead of just the ones identified in the Blueprint. While the deferred tax model is not without its challenges, these are not insurmountable and do not warrant rejection of a framework which is well-established, governed by accounting standards, and independently audited. Guidance would need to be developed to deal with adjustments necessary in this model just as with any other model.[12] Some of the key items that would need development include removing the impact of valuation allowances and addressing non-recognition of deferred taxes, addressing uncertain tax positions, changes in statutory tax rates, foreign exchange, deferred taxes related to OCI, and addressing initial recognition exceptions.

202. Recognizing the clarifications that will be required in developing this part of the Pillar Two framework, we encourage the Inclusive Framework to perform further work to ensure that a proportionate approach is available to minimize the risks identified above.

203. There is a majority consensus among our membership that although we believe timing differences should not give rise to IIR tax payments, where that outcome arises there should be an ability to obtain a refund for excess IIR credits. It is not clear that the IIR credit carry-forward approach would be allowed over a long enough period to match the reversal of timing differences in industries with long life cycles, which can be particularly harmful for industries having the highest capital intensities or the longest cycles. The absence of a carry-back mechanism exacerbates the detrimental outcomes where IIR tax payments must be made in respect of timing differences. To mitigate the net present value impact of payment of IIR liabilities in respect of timing differences, there must be an ability to monetize excess IIR credits by obtaining a refund. For example, a refund could be appropriate in situations where the group is not subject to lower rates of tax in future periods in any jurisdiction as the IIR credit would be useless. It would be a particularly unfair outcome for groups that are

[11] In some industries, such as insurance, the business cycle may last as long as 70 years.

[12] If companies need to keep a “third set” of records to comply with the GloBE, an ironic result is the creation of new deferred tax timing differences in group accounts.

routinely subject to low rates of tax to be able to offset whereas those which only incur IIR liabilities as a result of timing differences are unable to equalize their position. The net present value impact of IIR tax liabilities in respect of timing differences, coupled with limitations to utilization and monetization of IIR credits, will have a negative policy impact on investment, which may be particularly acute in resource rich countries or countries which require foreign investment in necessary infrastructure. In some cases, this may incentivize MNEs with excess IIR credits to seek lower tax rates on future investments at the expense of jurisdictions incentivizing capital investment through accelerated tax depreciation.[13]

Covered taxes

204. Business welcomes the broader approach adopted by the Inclusive Framework on the definition of what is considered as covered taxes; we agree the right approach is to rely on the form and intention of the tax before resorting to any legalistic or technical analysis.

205. The OECD might also consider the merits of having jurisdictions publish a positive list of national taxes deemed in scope in order to provide more certainty around the definition of covered taxes.[14] To the extent that a commitment to withdraw unilateral measures is not followed by a jurisdiction, then such taxes should be treated as covered taxes. CFC taxes should be fully allocated to the jurisdiction of the CFC and should become an indefinite carry-forward in that country applicable to future GloBE tax payments. Taxes imposed under the U.S. GILTI regime, similarly, should be treated as covered taxes. GILTI differs from traditional CFC rules in that GILTI income may include tested income from entities around the world; because the incremental tax imposed by GILTI is generally driven by income earned in low-taxed jurisdictions, however, we consider that such taxes should be allocated principally to low-tax jurisdictions. A potential consideration is the extent to which inclusion/exclusion of capital gains from the GloBE tax base might undermine the policy rationales in certain jurisdictions which offer gain relief (e.g., indexed relief for inflationary gains, etc.). As noted above, we believe it is essential that DSTs be withdrawn as part of any global consensus, and should in any case be treated as covered taxes.

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[13] On the issue of timing differences, a few members note the limited ability in the Blueprint framework to address UTPR tax payments that arise from timing differences. Any UTPR credit, carry-back, or refund process would be administratively difficult given the extreme complexity of the proposed UTPR collection and administration mechanisms, and the potential involvement of multiple taxing jurisdictions. If the Inclusive Framework membership insists on moving forward with an UTPR regime, these members believe that taxpayers may need an election to maintain excess covered tax carryforward accounts if they are willing to undertake the associated compliance burden. This concern ties into the comment below (in para. 249) that the UTPR should be delayed in its implementation given its complexities, the great risk of disputes among UTPR countries, and the need to work out the administrative burdens associated with the IIR regime before tackling the even greater administrative burdens associated with the UTPR regime.

[14] One member comments that the definition of covered tax should not be limited to taxes on profits, but rather expanded to also cover taxes on gross amounts, avoiding the “in lieu of” test as in practice many MNEs are taxed on both gross and net amounts, affecting their final results. The member contends it is incorrect to conclude that a company’s corporate tax payments represent the total of its direct tax contributions to a government. Accordingly, it would be preferable to link a MNE’s ETR to the concept of “taxes borne”, which refers to all of the taxes levied on a company which are a cost and affect its financial results, including corporate income tax and any other taxation on the revenues[14] and not only profits (as is contemplated in the current version of the Blueprint). The member believes that the taxes borne are a more complete and accurate measure of a company’s direct contribution to tax revenues and is therefore more aligned with the objective of minimum taxation pursued by the GloBE rules.

206. Any discrepancy in the allocation of the covered tax and the related GloBE tax base will inevitably lead to unintended GloBE tax that is not in accordance with the underlying policy objectives of Pillar Two. Yet it may be possible for a mismatch to occur, with income and a covered tax allocated to different jurisdictions, so Pillar Two should focus on introducing a backstop to ensure that in all circumstances both the covered taxes and the related income are allocated to one and the same jurisdiction. A clear outline of the guiding principles for the "cross jurisdictional" taxes that are common in an international tax context can work as the starting point for MNEs. The guiding principles for the correct allocation of income and covered taxes can be supplemented by installing monitoring and peer reviewing mechanisms.[15]

207. The Pillar Two proposals indicate that withholding tax accrued on an item of income that will be paid within 12 months is included in covered taxes. The use of deferred tax accounting would ensure accrued withholding tax is appropriately treated as a covered tax. The currently proposed restriction to 12 months is not adequate to deal with interest income in circumstances where payment of the interest and therefore the withholding tax will not occur until many years into the future. This will result in double taxation and will increase the cost of funding capital investments. Absent deferred tax accounting, potential solutions include removal of the time limit in relation to the inclusion of accrued withholding tax on accrued interest income in covered taxes, or an adjustment could be made to exclude interest income from the calculation of the GloBE base until it is paid in order to align outcomes related to interest expense, interest income and the payment of withholding tax.

Research and development

208. There has been a noticeable shift in government policy regarding support for company research and development activities over the past decade toward a greater reliance on tax versus direct support measures. Some members believe that countries should remain free to choose if and how they incentivize R&D activities (i.e., whether through direct government grants, tax incentives, or a combination of both) within the limits of BEPS Action 5, and that MNE groups should not be treated differently for GloBE purposes depending on the choice made by individual governments. The proposed GloBE rules effectively put a limitation on the use of R&D tax incentives, in favor of expenditure-based tax incentives that provide relief to payroll taxes or social security contributions; government grants; and qualified refundable R&D tax credits. Apart from the different accounting treatment, it is unclear what the rationale for this is, both from an economic and a BEPS perspective, particularly for expenditure-based R&D incentives (e.g., an R&D super deduction). We support making a permanent difference adjustment to the tax line for R&D super deductions or non-refundable R&D credits. Alternatively, we also support adding in an R&D super deduction to

[15] Some members believe the definition of Covered Taxes should also include all government take in respect of extractives, where the results and profits of extraction are often shared through various instruments. Failing to do so may cause certain resource rich nations to become uncompetitive despite high government take, whatever denomination that is under. The alternative is that Pillar Two would force resource rich nations to adjust their tax system, which is surely not the aim of Pillar Two. Nor is it the aim of Pillar Two to allow developed nations to tax those resource profits, simply because the instrument through which the results and profits of extraction are shared, is not characterized as a Covered Tax. There are many examples of government take which should be included. As a minimum, Covered Taxes should, apart from corporate taxes and WHT envisaged in the Blueprint, also specifically include: State share of extractive production, extractive Royalty payments, Petroleum production tax, and any other specific taxes imposed on volumes of resources produced and often linked to the profitability of the ventures. These taxes are driven by production volume and therefore could be arguably linked loosely to the profitability of the MNE, and in any case are a tax on the operations.

the GloBE tax base for the taxpayers that are otherwise claiming an R&D super deduction or non-refundable R&D tax credit.

209. One administrative aspect of concern is that many jurisdictions have prolonged due dates for tax returns or statutory financials for a subsidiary included in a consolidated financial statement. Each jurisdiction has different rules for depreciation reportable on its local statutory financials versus tax returns. However, taxes under Pillar One and Pillar Two may be due sooner than local statutory financials and tax returns are due. Considering all the above factors, we recommend that the Pillar Two administration be timed so that the local tax returns can be filed and therefore the covered taxes used in the ETR calculations can be ascertained.

Ownership threshold

210. Identifying the equity holding percentage with regard to portfolio investment will be a challenge. Consequently, members believe that consideration could be given to excluding all dividends (including portfolio dividends) from the GloBE tax base for the sake of simplicity. Alternatively, many members support a threshold of a direct or indirect ownership interest of 10% or less, or 15% being treated as portfolio (as this low percentage of ownership is generally seen as a passive investment holder).

Chapter 4. Carry-forwards and carve-out

211. Some members believe that without unlimited carry-forward for pre-GloBE losses, the proposed framework is insufficient to account for MNEs with long-term business cycles and is particularly relevant given the negative effects COVID-19 is having on many businesses. A limited loss inclusion period also stands in contrast to and inconsistent with the Pillar One acceptance of unlimited loss carry-forward. It is also contrary to the stated aims of Pillar Two in targeting low taxes over time, not just due to changes from one year to another, or due to entirely reasonable operational losses encountered. To the extent that deferred tax accounting is adopted, the pre-regime losses should be appropriately addressed (although some adjustments may be required for previously unbooked deferred tax assets).

212. We welcome the proposal to allow historic timing differences to be recognized on commencement of the GloBE regime. The most robust way to achieve this is to apply deferred tax accounting to determine the effective tax rate for Pillar Two, which means that to the extent carry-forward losses or other opening differences relate to timing differences, they will effectively be brought into the regime.[16]

213. The transitional rules as proposed do not adequately address the recognition of historical timing differences for two key reasons. First, the transitional measures propose a limited "look back" time period to recognize GloBE losses on commencement of the regime. Second, the proposed transitional rules are limited to carrying forward GloBE losses (akin to accounting losses) and do not recognize timing differences between tax and accounting, including carry-forward tax losses and other items that are often very material.

214. Capping the transition of pre-regime losses (either accounting or tax losses) to income years immediately preceding the commencement of GloBE will result in tax liabilities in excess of economic income and will result in distortionary outcomes between projects depending on when in the life cycle of that project the GloBE regime commences. Instead, there should be

[16] A few members believe that deferred tax accounting will not fully resolve issues of pre-regime losses or timing differences, and so would prefer being able to electively choose between using existing tax assets (based on local rules) or the use of deferred tax accounting rules.

an unlimited look back to recognize GloBE losses on commencement of the regime. Once these GloBE losses are brought into the regime, there should be an indefinite carry-forward of these losses due to the very long economic cycle of capital-intensive projects. The GloBE losses to be brought in need to be calculated using whatever methodology is determined appropriate to address timing differences in the core GloBE rules. A simplification option (such as a 3-5 year "look back") could be offered for MNE Groups that do not want the compliance burden of computing and recognizing timing differences on commencement of the regime.

215. The GloBE rules are technically complex and potentially apply to income that is subject to high rates of tax over time but appears low-taxed in a particular period due to timing and other differences between local taxable income and profits before tax. If there is no holistic solution to address prior period losses and timing differences within the GloBE rules, excess taxes should be carried forward indefinitely to mitigate the potential for excessive taxation and to smooth out such timing differences. In the event they are needed, the obligation to establish and maintain carryforward accounts would be on the taxpayer; accordingly, there would be no additional administrative burden placed on tax authorities or taxpayers that did not wish to carry forward taxes from pre-regime periods.

216. It would be helpful to clarify that tax paid in a subsequent year in the normal course should be included as a covered tax (e.g., accrued tax in year one but payable in year two when a tax return is filed). Similarly, there should be a mechanism to refund top-up tax in circumstances where there is an amended assessment for local tax purposes in an income year (i.e., an increase in local tax liability) showing that top-up tax should not have been paid.

Formulaic substance-based carve-out

217. For the carve-out to properly recognize those activities, an MNE group that claims the benefit of the carve-out should not be required to make a corresponding and proportional adjustment to the covered taxes. The Inclusive Framework should consider clarifying the extent to which covered taxes attributable to excluded income flowing from a substance-based carve-out are to be excluded in determining the jurisdictional ETR, as the current Blueprint language is not clear. Also unclear is whether the substance-based carve-out is taken into account when calculating the top-up tax. It is important that the rate of return should be sufficiently high in recognition of an MNE group's underlying substantive activities.

218. The asset-based carve-out should be based on the carrying value of tangible assets and not merely the depreciation. A return-on-assets approach might provide a method for determining a routine return to business investment. This is recognized by the OECD Transfer Pricing Guidelines (see para. 2.98 and 2.103), which provide that a return on assets is appropriate in evaluating the profits of manufacturing or other asset-intensive activities, and that cost-based indicators should be used only in those cases where costs are a relevant indicator of the value of the functions, assets, and risks of a business. A return-on-assets approach is also consistent with the U.S. GILTI rules, and with sound economic and finance theory (pursuant to which returns are earned on investments, not expenses). While there is a mathematical relationship between depreciation expense and carrying value, a "routine" mark-up on depreciation expense is likely to fall far short of a routine return on the carrying value of long-lived assets in a capital-intensive business. The use of a mark-up on depreciation expense in the carve-out, rather than a return on tangible assets, effectively penalizes capital-intensive businesses in a manner that is inconsistent with the objectives of the GloBE rules.

219. There is also considerable belief among members that a carve-out should include some measure of intangibles given their increasing importance as a production factor in addition to people and fixed assets in an innovative and modern economy. A deemed intangible asset carve-out could be based on the location and amount of accumulated internal R&D spend and be a percentage of the carrying value of the internal R&D carrying value.

220. Some members recommend consideration for providing a higher percentage mark-up for different categories of payroll costs, including for strategic management and research and development. This would be consistent with providing a functional routine return to the local activities of the Constituent Entity. The substance-based carve-out could also build on the Pillar One concept of an “Amount B” routine return as regards marketing and distribution activities, which could significantly reduce the compliance burden for groups that are present in many countries with local routine distribution activities that are not relevant to the policy objective of Pillar Two.

221. In addition to payroll and tangible asset-related expenditures, some members believe that the local sourcing of raw materials can be seen as a substantive activity less susceptible to BEPS risks and thus should be considered for carve-out as well, by factoring in a certain percentage of locally sourced raw materials (e.g. value-added percentages released by the OECD).[17]

222. The current proposals do not fully appreciate that taxpayers may have already established mid- to long-term business strategies based on existing tax regimes. Such strategic decisions, especially on investment which has already been made or is on-going, cannot be withdrawn or revisited within a short period of time simply to comply with new tax rules. For this reason, some members believe that existing bona fide tax credits and tax incentives in local jurisdictions should be considered or at a minimum, allow substance-based carve-outs from existing regimes aimed at attracting investment that are compliant with the BEPS Action 5 standards. This could also address concerns from many jurisdictions that have rules in place which prohibit the retroactive application of new legislation.

223. Some members consider the formulaic substance-based carve-out, while favorable in certain circumstances, to require a high degree of complexity with regard to compliance. Accordingly, the Inclusive Framework might consider making the carve-out optional for taxpayers to utilize without it being mandatory for those who do not want the additional complexity.

224. Finally, some members believe that a carve-out for GloBE must be consistent with the BEPS work already undertaken in Action 5, such that regimes found to be fully BEPS compliant should be subject to a GloBE carve-out – particularly regimes with strong economic rationale, such as R&D tax credits, R&D super deductions, accelerated capital allowances, and BEPS-approved patent boxes.

Chapter 5. Simplification options

225. Providing meaningful simplification will be critical to ensuring that Pillar Two can achieve its articulated policy goals in the least burdensome manner. We encourage the OECD to further develop these and other options. A pressing need for simplification occurs because for many MNEs, with a significant number of constituent entities spread around the world, jurisdictional blending would require annual ETR computations in many jurisdictions that are

[17] If deemed difficult to isolate the amount of locally sourced raw materials, then consideration could be given of total raw material amounts with factoring in of a slightly lower percentage for a carve-out.

always likely to be above the minimum rate. Simplification can also reduce compliance burden by ensuring that the full Pillar Two calculations, with their complicated system of carryovers, are reserved for situations presenting the risks that GloBE is intended to address. Given that MNE groups differ significantly across the globe with unique circumstances, we believe that all the simplification measures proposed in the Blueprint should be implemented after evaluation, based on actual results, and further refinement. Genuine simplification will involve reliance on a risk-based approach, however, in order to avoid merely alternate complex calculations.

226. However, simplification options should not be seen as a cure for inadequacies in the core GloBE rules. Fundamental issues such as the treatment of timing differences must be appropriately dealt with in the base rules rather than relying on simplification options to patch the gap. Members do not have confidence in the consistent implementation, application or longevity of the simplification rules to trust that these rules will correct for inadequacies in the core rules to address anomalous outcomes.

Tax Administration guidance:

227. From a pure compliance perspective, tax administration guidance is a preferred first step, as it is the easiest method for businesses to follow and comply.

228. As this would be a new process with political pressures at play, one way forward could be that jurisdictions would voluntarily enter a quasi-review process, creating an incentive for other jurisdictions to join while not being mandatory. This would increase tax certainty for both taxpayers and also tax administrations.

229. Frequent requests by a tax authority to calculate ETR would undermine the usefulness of this simplification, and we believe MNEs should be subject to ETR re-calculation only in very limited circumstances.

CbCR safe harbor:

230. A form of ETR safe harbor based on CbCR data does seem possible and attractive, subject to further development, particularly if it spares companies from the need to compute and track a multitude of carry-forward and IIR tax credit computations. The OECD might consider a multi-year averaging approach in order to address timing or similar risks of mismatch. It is imperative that an ETR safe-harbor based on CbCR data truly function as a safe-harbor or be elective, as some members are opposed to using CbCR data in any circumstance (whether for Pillar One or Pillar Two).

231. One element to avoid in a CbCR safe harbor is a requirement for frequent fulsome computations, which would necessitate annual analysis for comparison purposes to the detriment of the simplification intent. Indeed, incorporating required adjustments into CbCR data may not represent true simplification and instead, may be more complicated to implement from a process and technology standpoint.

232. Some members feel that requiring adjustments to CbCR data to account for permanent differences is too complicated and would prefer an ability to either use current consolidated data regarding different taxes to explain the ETR or to use total tax. Another suggestion is to use CbCR data as-is (while perhaps meeting a higher tax threshold) or give companies an option to combine CbCR data with deferred taxes for the benefit of simplification (particularly for companies with material timing differences). Regardless, the number of required adjustments to use CbCR as a basis for the GloBE ETR calculation should be kept to a minimum.

233. Members reiterate that the CbCR report is solely a high-level risk assessment tool, with information prepared on this basis. Therefore, some companies view CbCR as an unsuitable tool for Pillar Two absent a number of required adjustments to the data before the report would be meaningful. Accordingly, these members feel that utilizing CbCR data is unlikely to lead to reduced compliance costs or efficiencies. In addition, the Pillar Two Blueprint notes that information required to be reported in CbC reporting may be modified in the future to include movements in deferred tax and some of the other adjustments contemplated in the GloBE ETR calculation. These members are concerned that the development of a CbCR safe harbor could be used to justify the need for expanded CbCR reporting that would not otherwise be necessary. This would have the non-intuitive result of increasing overall complexity and compliance burden for the ostensible purpose of simplifying GloBE compliance.

234. These members are also concerned that using the data for purposes of the GloBE rules will increase the likelihood that it will be used by tax authorities for other purposes, leading to increased disputes. In this regard, Business at OECD notes that any CbCR safe harbor should be for purposes of Pillar One and Pillar Two only consistent with its intended role for risk assessment and should not be taken as a modification of the fundamental premise of CbCR.

De minimis profit exclusion

235. The proposed de minimis profit exclusion is a useful simplification measure that should be adopted; however, it could be based on a percentage and not on a fixed de minimis threshold such as the €100 000 figure suggested in the Blueprint (which seems to be too low to have any material simplification effect), or else be structured as a combination of a fixed amount and a relative amount based on a percentage. Further improvements could be considered regarding the threshold, such as allowing MNE groups to take into account profitable Constituent Entities only and to exclude loss-making Constituent Entities in order to compare the net income of a profitable Constituent Entity with the net income of all other profitable Constituent Entities. Otherwise, the sum of all profitable Constituent Entities would exceed 100%. In addition, there is a need to clarify which measures of PBT should be taken into account; for simplicity, we suggest that groups should be allowed to take the PBT from consolidated financial statement accounts.

Other simplification measures

236. Members strongly support a simplification measure that would provide an exemption from the GloBE rules for any MNE that could demonstrate that its global effective tax rate was higher than the GloBE minimum rate.

237. One new safe harbor approach would spare MNE groups from the burden of systematically recomputing the tax base on the whole group basis by allowing the group to rely on its worldwide ETR as drawn from the financial statements without having to adjust for differences (as proposed in the Blueprint). The UPE tax administration could provide clearance of the worldwide ETR calculation, which would be binding on other jurisdictions. Where the MNE group's worldwide ETR is equal or above the agreed minimum tax rate, the MNE group would not be required to take any further action. When a MNE group's ETR is below the minimum tax rate, the group would be allowed to justify its low ETR based on facts and circumstances, e.g. by providing evidence of permanent or temporary differences.

238. As an alternative, based on the rationale that an MNE group engaged in profit shifting would primarily do that from the UPE jurisdiction to low-tax jurisdictions, the comparison could be made with reference to the statutory CIT rate of the UPE. In such alternative, in order to acknowledge the sovereignty of each jurisdiction in determining its CIT rate, no ETR

calculations would be required for any group company for a certain year as long as the ETR of the MNE group as per consolidated financial statements exceeds a certain percentage of the statutory rate of the UPE jurisdiction. In order to still safeguard some minimum tax level for MNE groups which may have located their top parent company in a low-tax jurisdiction for tax avoidance purposes, this could be combined with a minimum acceptable ETR for the group of no less than the minimum tax rate.

239. Additionally, many countries have introduced measures in line with the BEPS Final Report, such as Action 3 regarding CFC regimes, which takes into account entity-by-entity ETRs. A simplification measure could leverage certain criteria based on the ETR in countries with a CFC tax regime consistent with BEPS Action 3, thus narrowing the number of jurisdictions subject to IIR ETR calculations.

Chapter 6. Income Inclusion and Switch-over rules

240. To re-emphasize our comment from the December 2019 letter on Pillar Two, the IIR should be the primary rule with respect to the UTPR and STTR, and apply only at the ultimate parent level.

Split-Ownership Rules

241. Based on the Blueprint details, all directly and indirectly owned subsidiaries and lower-tier entities will be required to consider applying the IIR split-ownership rule. This will undermine the efficacy of the top-down approach of the IIR and significantly increase the burden on companies, as they will need to understand the percentage of ownership of subsidiaries in each country and the IIR system in each country. Compared to the policy objective, the split-ownership rule will lead to a heavy administrative burden on companies, so the introduction of this rule should be very carefully considered in light of the project's overall aim to lessen complexity.

242. The Blueprint raises concerns about tax avoidance in which the ultimate parent entity spins off a portion of its interest in a subsidiary to its shareholders, but if the ultimate parent entity is a publicly traded company, it is not a reasonable decision to pass control of the subsidiary to other shareholders for the sole purpose of reducing the tax burden. The split-ownership rules should only address specific situations, such as cases where a few individuals control the ultimate parent entity. An exception from the split-ownership rules could apply for partially-owned parents where are publicly listed or widely held.

243. In addition, the rules in relation to a partially owned intermediate parent will require adjustments to ensure ultimate parent entities can use excess IRR credits against their other investments (otherwise these will be 'trapped') in the partially owned parent.

Chapter 7. Undertaxed payments rule

244. Because timing differences can have a negative effect under the UTPR rules, the OECD might consider applying a long cycle (e.g., every 5 years) to smooth out timing differences.

245. UTPRs should not be applied to payments to a UPE of an MNE. The objective of Pillar Two is to ensure a minimum level of tax on foreign income earned by MNEs in order to address perceived remaining international base erosion and profit shifting issues. The home jurisdiction of an MNE typically is the center of that MNE's economic interests and the place of ultimate management of the MNE. The home jurisdiction is more appropriately considered to be the natural location of the residual profits arising from the operation of the business, rather than a place to which profits are shifted to minimize tax.

246. While all jurisdictions have a sovereign right to determine their own tax systems, that right is especially pronounced with regard to the system for taxing resident MNEs (as recognized implicitly by the design of the IIR, which permits the home jurisdiction of an MNE to impose a top-up tax on low-taxed foreign subsidiaries). The home jurisdiction of an MNE should have the right to determine the appropriate manner of taxing the domestic income of its resident UPE, balancing revenue concerns with tax incentives to encourage positive economic activity within its jurisdiction. Applying the UTPR to payments to UPEs would inappropriately encroach on the right of the home country to balance these domestic policy interests.

247. An obvious solution to this issue is to exempt the payments to UPEs from the UTPR. To the extent there is a concern that such an exemption could facilitate profit shifting, for example in cases in which the UPE is not located in a jurisdiction that represents the center of its economic activities, targeted rules can be designed to mitigate such concerns. For example, the exemption for payments to UPEs can be limited for UPEs located in jurisdictions identified as “investment hubs” by the OECD (FDI to GDP of 125%), unless the UPE’s activities in its home jurisdiction met objective substance-based criteria (e.g., relative headcount or tangible assets).

Chapter 8. Special rules

248. We are concerned about the simplified IIR. If associates and joint ventures were subject to simplified IIR, a new reporting process would need to be established in order to obtain information from unconsolidated associates, which will impose a significant administrative burden. MNEs do not control unconsolidated associates and the risk that they will be used for tax avoidance purposes is very low. Unconsolidated associates may also be a subsidiary of another MNE, which is subject to an IIR.

Chapter 9. Subject to tax rule

249. The Blueprint assumes that BEPS risks continue, without much explanation as to what the original BEPS Action measures have done to reduce such risks. This raises the question of how and why the STTR is conceived as an appropriate tool to combat such perceived hazards. A withholding tax regime is always a blunt policy instrument and should be avoided unless absolutely necessary. Indeed, by levying a gross basis withholding tax on a wide range of payments (and which has been given priority over the GloBE rules), it sets a bad precedent and represents a departure from long-established principles for profit-based taxes. The STTR will likely lead to double taxation, which is counter to efforts by the OECD over many decades to reduce tax barriers to cross-border trade and investment. Transfer pricing rules and domestic general anti-abuse rules and doctrines are adequate to police abusive tax planning based on deductible payments to a low-taxed related party. On the whole, most members believe the STTR is incompatible with the main aims of Pillar Two and should be eliminated from the framework.

250. Nevertheless, in understanding that the STTR is important to developing countries and unlikely to be removed, we request clear guidance from the OECD on the operation of the rule. We believe that it should only be imposed on payments to countries with a nominal (i.e., statutory) tax rate below a pre-determined ‘trigger rate’, and the rate of withholding tax should be extremely modest to avoid double/excessive taxation. We believe that it is also essential to incorporate bilateral processes (e.g., discussion and listing processes) concerning any base-narrowing measures rather than introducing unilateral rights to impose an STTR charge based on taxpayer-generated information; otherwise there may be a broader undermining of bilateral tax treaty arrangements.

251. The status of the STTR in the context of the global treaty network should also be clarified. We recognize that countries are free to adopt an STTR in their tax treaty practice, either through another multilateral instrument or through individual modifications to bilateral treaties. An across-the-board implementation of those changes in all treaties, however, risks upsetting the existing balance of bilaterally negotiated treaty benefits. If a decision is made to include the STTR in a multilateral instrument to implement the Pillar Two outcomes, we believe it should not be treated as a minimum standard for joining that instrument. Instead, each country should be able to choose whether it believes the STTR is an appropriate modification to its existing tax treaty. Each treaty should be modified only where both treaty partners have agreed to the change. Where no such agreement is present, the matter should be left to bilateral negotiation.

252. Given the vague language in the Pillar Two Blueprint, it seems possible for the STTR to be applied to service income, which seems to contravene an underlying element of GloBE, as services are generally neither passive nor high-margin activities. It may be advisable to clarify that the exclusion for low return payments (para. 613) applies not only to cost reimbursements and low-margin cost-plus arrangements, but also to situations such as funding receipts where equivalent expenditures must be made.

253. The Blueprint identifies certain "other covered payments" (para. 590 et seq.) to which STTR will apply based on the belief that such payments present "greater BEPS risk" in part because of linked mobile factors. However, this approach is not aligned with OECD Transfer Pricing Guidelines applicable to normal business transactions of regulated entities (see, e.g., TPG para 10.199).

Chapter 10. Implementation and rule coordination

254. To the extent that the IIR and UTPR measures are to be implemented through domestic legislation, it is critical that any agreed implementation minimize potential inconsistencies in both domestic law and subsequent interpretation. Otherwise, the likelihood of resulting double (or more) taxation from Pillar Two is significant. Implementation measures should contain provisions for dispute prevention and dispute resolution, such as a process to validate the IIR computation that would be binding on other jurisdictions (and prevent the application of UTPR, STTR, etc.).

255. In addition, given the complexity of the UTPR and the greater risk of disputes when it applies, we believe that jurisdictions should be given sufficient time to introduce an IIR before any UTPR would be activated by a country. Having a "critical mass of jurisdictions" sign on to Pillar Two before the UTPR provisions can be activated is important to help alleviate significant administrative burden for MNEs during any selected transition period.

256. It is critical for the implementation framework of Pillar Two to minimize the opportunity for deviations in domestic legislation, and any such departures to be based on clear principles. The current framework leaves too much room for elements outside of the IIR to apply to intragroup payments; such rules should be limited to the extent payments are made by entities subject to a compliant IIR regime.

257. To the extent that the MAP process is to be leaned on in providing dispute resolution for issues arising under Pillar Two, it bears noting that most MAP expertise is concentrated in Articles 5, 7 and 9 disputes; the number of MAP cases in the corporate space outside of these Articles is typically very small relatively speaking and therefore Competent Authority expertise in this area is naturally limited. MAP teams would need to be expanded and trained accordingly to cope with an increase in new disputes.

258. Furthermore, OECD Model Article 25(3) is increasingly used to insert disputes concerning measures similar to IIR and GLoBE into treaty discussions. While Article 25(3) is helpful in this respect, it only allows for consultation and not for resolution of cases not provided for in the treaty. To get the full benefit of Article 25, these new measures would need their own treaty provision within bilateral treaties.

259. Another option would be to consider or encourage the introduction of clearance mechanisms that would give business an opportunity to avoid disputes and obtain early certainty. Given the very clear differences between Pillar One proposals (which concern primarily a process of reallocation of tax rights) and Pillar Two proposals (which are primarily minimum tax measures of a more domestic relevance), we would not recommend that any early certainty or clearance regimes for Pillar Two were combined with those suggested for Pillar One.

APPENDIX A

The use of group-wide profitability could be expanded to prevent taxation of loss-making group companies. Group profit could be used as a "tax cap" method of exempting loss-making groups from profit taxes, so that the tax liability would never exceed the amount of group profit.

The following example details the computation of the group profit (tax cap), assuming a group of companies, with a principal, two limited risk distributors and sales subject to WHT in a fourth country.

Group profit	**5**	**5**
Country	**Tax assessed (CIT/WHT)**	**Tax after capping**
A (Principal)	0	0,00
B (LRD CIT)	5	2,50
C (LRD CIT)	3	1,50
D (Sales WHT)	2	1,00
Total	**10**	**5**

The use of the tax cap requires information on taxes assessed per country, which should be achievable as part of the centralized dispute prevention process, and business believes the tax cap should be applied at the taxpayer's option.

ADDENDUM:
COMMENTS ON THE OECD SECRETARIAT'S ECONOMIC IMPACT ASSESSMENT

I. INTRODUCTION

On October 12, 2020, the OECD publicly released the Secretariat's 283-page Economic Impact Assessment (EIA) of the Pillar One and Pillar Two proposals currently being discussed by the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) as part of its work to address the tax challenges arising from the digitalization of the economy. [18] The EIA updates preliminary results presented by the Secretariat in a webcast held on February 13, 2020.[19]

Based on assumed design parameters, the EIA provides estimated ranges for the effects of portions of Pillar One (Amount A) and Pillar Two (Income Inclusion Rule and Undertaxed Payment Rule) on global tax revenues and investment by country groupings. The underlying data cover 200 countries and 27,000 MNEs. BIAC congratulates the Secretariat team for the enormous amount of data and modeling work that was done to prepare the EIA and recognizes the challenges inherent in an analysis of this type given significant data limitations and uncertainty about: (1) how Pillars One and Two might be implemented, (2) how companies might change their behavior, and (3) how governments might change their tax regimes in response.

BIAC commends the Secretariat for the detailed documentation contained in the report regarding data sources, assumptions, and methodology, and appreciates the original research undertaken to inform the analysis.[20] BIAC recognizes that full transparency regarding individual country effects was not possible for reasons outside the Secretariat's control.

Although the Public Consultation Document does not specifically request input on the EIA and related documents, BIAC is submitting these comments because the economic analysis is critical to policymakers' considerations of Pillars One and Two.

II. KEY POINTS

The EIA likely over-estimates the revenue that would be collected under Pillars One and Two due to assumptions that differ from technical elements contained in the Blueprints. For example, with respect to Pillar One, the EIA does not consider loss relief, the role of segmentation, the rejection of

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[18] OECD (2020), *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/0e3cc2d4-en.

[19] OECD, Webcast: Update on Economic Analysis and Impact Assessment, 13 February 2020, http://www.oecd.org/tax/beps/webcast-economic-analysis-impact-assessment-february-2020.htm

[20] *See*, (1) Hanappi, T. and A. González Cabral (2020), "The impact of the pillar one and pillar two proposals on MNE's investment costs: An analysis using forward-looking effective tax rates", *OECD Taxation Working Papers*, No. 50, OECD Publishing, Paris, https://dx.doi.org/10.1787/b0876dcf-en; and (2) Millot, V. et al. (2020), "Corporate Taxation and Investment of Multinational Firms: Evidence from Firm-Level Data", *OECD Taxation Working Papers*, No. 51, OECD Publishing, Paris, https://dx.doi.org/10.1787/9c6f9f2e-en.

the quantitative approach to determining the jurisdictions that cede residual profits, and the loss in revenues from the required removal of DSTs and other unilateral measures (including certain withholding taxes). With regard to Pillar Two, the analysis disregards loss and credit carryforwards that are described in the Blueprint.

Data issues also affect the EIA estimates. For example, the EIA relies on data from tax years preceding implementation of the BEPS measures and U.S. tax reform, thus excluding subsequent behavioral changes directly at issue in the Blueprints (e.g., profit shifting). In addition, the country-by-country report data used in the EIA includes double counting of inter-affiliate dividends that understates countries' effective tax rates.

The methodology and assumptions used in the EIA underestimate the effect on investment, innovation, and growth. For example, the EIA does not consider the effect of the Pillar One and Two proposals on investment in research and development, which currently benefits from a variety of tax incentives and preferential regimes. The analysis also does not consider the impact of the Pillar Two on tax incentives for decarbonization, which are an important tool that governments are using to address climate change. Unlike the revenue estimates, the investment impacts are presented as point estimates, rather than as ranges showing the sensitivity to alternative assumptions.

In view of the extraordinary complexity of the proposals in the Blueprints, it would be helpful to policymakers if the OECD were able to provide estimates of the costs of compliance and administrations, which may be quite large relative to the revenue raised.

III. REVENUE ANALYSIS

A. Pillar One Revenue Estimate

Amount A is estimated to increase global corporate tax revenues by about one-third of one percent at midpoint values. Amount A involves a reallocation of income among countries and thus the revenue effect is attributable to the difference between the average tax rates in paying and receiving countries.

There are several reasons the estimated revenue from Amount A, although small, may be overstated:

- The revenue estimate is based on 2016-17 data, before full implementation of the 2015 BEPS actions and the U.S. Tax Cuts and Jobs Act (TCJA). The BEPS actions are intended to ensure profits are taxed where economic activities generating are performed and value is created. Consequently, implementation of BEPS actions will reduce income reported in low-function, low-tax countries and thus narrow the difference in average tax rates between countries paying and receiving income re-allocated under Amount A.

- The revenue estimate assumes the rate at which Amount A is taxed in paying jurisdictions is the *average* tax rate, while the rate at which Amount A is taxed in the receiving jurisdiction is the *statutory* tax rate. It is unclear why this asymmetry in tax rates is assumed. The revenue estimate would be reduced if, as would seem more appropriate, symmetrical tax rate measures were used.

- The revenue estimate does not account for utilization of losses under Pillar One. To the extent Pillar One provides some form of relief for losses, the revenue estimate is overstated.

- The revenue estimate does not account for segmentation. Many companies have lines of business that are both inside and outside the scope of Pillar One. The effect of segmentation can be to increase or decrease the amount of residual profits subject to reallocation. However, to the extent the Pillar One rules allow some degree of flexibility in segmentation, there is a greater likelihood that segmentation ultimately would reduce the estimated revenue gain.

- The Pillar One Blueprint describes two method for identifying the paying entity. The "quantitative approach" would rely on the same formula that is used to measure residual profits at the group or segment level, while the second method would follow a possible four-step method. The four-step method initially identifies paying entities as those that perform activities that make a material and sustained contribution to the group's ability to generate residual profits. It is important to note that the Blueprint rejects the quantitative approach for two technical reasons, yet the revenue estimate of Pillar One is based on the rejected quantitative approach. To the extent paying jurisdictions identified under the four-step method tend to have higher tax rates than those identified under the quantitative method, the revenue estimate will be overstated. It would be helpful to policymakers if the Secretariat were able to assess the sensitivity of the results to this assumption.

- The Pillar One Blueprint states, "It is expected that any consensus-based agreement under Pillar One must include a commitment by members of the Inclusive Framework to implement this agreement and at the same time to remove relevant unilateral actions."[21] However, the EIA's revenue estimate does not account for the loss in government revenues attributable to repeal of existing (and planned) digital services taxes.

The EIA does not include a revenue estimate of Amount B, which would provide a fixed return for certain marketing and distribution activities. As Amount B has the potential to raise more revenue than Amount A (both globally and in certain market jurisdictions) it will be difficult for policymakers to judge the full effect of Pillar One without revenue estimates of Amount B. BIAC recognizes the challenges in assessing the revenue effect of Amount B, but encourages the Secretariat to provide estimates under a range of plausible assumptions.

For purposes of evaluating Pillar One, it would be helpful to policymakers if the Secretariat were able to provide an estimate (or range of estimates) of the additional compliance and administrative costs for affected multinational companies and tax administrations. BIAC is concerned that the costs to taxpayers and tax authorities of complying with and administering Pillar One, especially Amount A, potentially are large relative to the revenue at stake.

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[21] OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris, paragraph 808, https://doi.org/10.1787/beba0634-en.

B. Pillar Two Revenue Estimates

The IIR and UTPR are jointly estimated to increase global corporate income tax revenues by 2.3 percent at midpoint values excluding the revenue currently raised by the U.S. GILTI regime (which is assumed to be a compliant regime). As the IIR is assumed to be adopted universally, none of the revenue estimate is directly attributable to the UTPR.

As detailed below, there are a number of reasons why the revenue gain from the IIR/UTPR regime in Pillar Two may be overstated.

- The Pillar Two revenue estimate is based on 2016-2017 data, before full implementation of the 2015 BEPS actions. The BEPS actions will restrict the ability of companies to reduce tax paid with respect to mobile income. Consequently, the amount of top-up tax that is estimated to be collected under Pillar Two based on 2016-2017 data is likely greater than the amount of revenue that would be collected if imposed post-2020.

- The revenue estimate is based in part on aggregated data from Country-by-Country Reports (CbCRs). Prior to guidance issued by the OECD in 2019, some companies included inter-affiliate dividends in their reporting.[22] As the average tax rate is artificially lower in jurisdictions where inter-affiliate dividends are included in pre-tax profits, the estimated top-up tax revenue will be overstated in such cases.

- As described in Section 4 of the Pillar Two Blueprint, the top-up tax calculation allows: (1) a deduction against the current year GloBE tax base for losses incurred in prior periods, and (2) a credit for taxes paid in excess of the minimum tax rate in a prior year or, potentially, in another jurisdiction. Both these adjustments have the effect of reducing the amount of top-up tax collected. The EIA does not account for either of these adjustments and thus the revenue gain potentially is overstated.

- Many countries have CFC regimes that currently tax parent companies on the passive income of their foreign subsidiaries. Consequently, this passive income would not be subject to the top-up tax if the parent country imposes corporate tax at a rate equal to or above the IIR rate under its CFC rules. Similarly, some countries have adopted switchover rules that impose current tax on income earned by foreign subsidiaries in low-tax countries; consequently, such income typically would not be subject to the top-up tax. The EIA does not appear to exclude income subject to CFC or switchover regimes in estimating the revenue effect of the IIR, potentially overstating the revenue gain.[23]

- Approximately 40 percent of the revenue estimate at midpoint values is attributable to behavioral responses of the companies affected by the top-up tax; specifically, the

[22] OECD (2019), *Guidance on the Implementation of Country-by-Country Reporting – BEPS Action 13,* OECD, Paris. www.oecd.org/tax/guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.pdf
[23] If income subject to tax at a rate above 12.5 percent by a foreign jurisdiction is within scope of the home country's CFC rules, then the effect of the CFC rule may be to increase the amount of tax imposed under Pillar Two where the other income earned in the foreign jurisdiction is taxed at a rate below 12.5 percent.

shifting of income out of low-tax countries (i.e., countries that impose an average tax rate of less than 12.5 percent) to high-tax countries. As the top-up tax narrows the rate differential between low-tax and high-tax countries, companies would be less likely to incur costs (e.g., foregone deductions) to shift mobile income to low-tax countries. However, it is less clear that companies would undo current tax planning (e.g., repatriate intellectual property to a high-tax jurisdiction), where the result would be a higher tax burden than paying the top-up tax. Econometric analyses of the sensitivity of income location to tax rate differentials typically provide more information about long-run rather than short-run responses. Consequently, the 40 percent portion of the Pillar Two revenue estimate attributable to a reversal of income shifting may take many years to materialize.

- While the revenue estimate account for changes in income shifting, it does not consider other behavioral responses. For example, companies may combine high- and low-margin lines of business to reduce exposure to the top-up tax in Pillar Two. This type of response would reduce the revenue raised by Pillar Two and would reduce economic efficiency.

- The revenue analysis does not account for the effect of the proposals on the amount or location of investment. As the EIA itself estimates there would be a decline in global investment, global tax revenues would be expected to fall as well.

- Approximately 20 percent of the revenue estimate at midpoint values is attributable to pockets of low-taxed income in high-tax countries. Absent the data needed to make a precise estimate, the EIA assumes the upper bound revenue gain from the IIR/UTPR regime is 40 percent greater (assuming a 10-percent formulaic carveout for depreciation and payroll) due to these pockets of low-taxed income.[24] Inclusive Framework countries could make more precise estimates using disaggregated CbCR data and, ideally, these estimates would be shared with the Secretariat to refine the EIA. That said, there is a possibility that high-tax countries with pockets of low-taxed income due to tax incentives, (e.g., patent boxes, research credits, etc.) might substitute non-income-tax incentives (e.g., reduced payroll tax rates for R&D workers) in response to Pillar Two. If such substitution occurs, the net budgetary effect may be less than the increase in corporate tax revenues.

- The revenue estimate assumes low-tax countries (but not countries without corporate income taxes) raise their corporate tax rates to 12.5 percent on half of corporate income in response to Pillar Two. However, none of this additional revenue is assumed to be used to attract foreign investment, either through a reduction in non-income taxes (e.g., labor and property taxes) or direct subsidies. If low-tax countries use some or all the revenues derived from "soaking up" the top-up tax to attract foreign investment, the portion of the revenue estimate attributable to a reduction in income shifting is likely to be overstated.

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[24] OECD, Economic Impact Assessment, *op cit*. p. 137, footnote 21.

- In the preliminary economic impact analysis that was presented by the Secretariat in a webcast on February 13, 2020, the revenue attributable to Pillars One and Two combined was approximately equal to the revenue effect of Pillar Two alone.[25] In other words, the revenue raised by Pillar One was estimated to offset the revenue raised by Pillar Two approximately dollar for dollar. This result seems plausible as, on balance, Pillar One reallocates profits from low-tax to high-tax jurisdictions, leaving less low-taxed income to be topped up by the IIR. By contrast, in the EIA, Pillar One has no discernible offsetting effect on the lower or upper bounds of the revenue estimated to be raised by Pillar Two. The EIA does not explain the apparent change in methodology.

The revenue estimate of Pillar Two does not include two of the four components of the GloBE proposal, i.e., the STTR and the switchover rule. If the STTR has priority over the IIR, it could have a material effect on the reallocation of revenues among countries. Consequently, it would be helpful to policymakers if the Secretariat were able to estimate the revenue and distributional implications of alternative STTR options.

Pillar Two, like Pillar One, is likely to impose substantial new compliance and administrative burdens on affected taxpayers and tax authorities. Thus, it would be helpful to policymakers if the Secretariat were able to provide rough estimates (or a range of estimates) of these compliance and administration costs.

IV. INVESTMENT EFFECTS

On a global basis, the EIA estimates the two Pillars (mostly Pillar Two) would increase the weighted average global Effective Marginal Tax Rate (EMTR) by 1.4 percentage points, from 25 percent to 26.4 percent, reducing marginal after-tax profits by about 1.9 percent, from 75 percent to 73.6 percent. Relative to the status quo, the direct effect of this increase in EMTR is estimated to reduce global investment by about 0.1 percent of GDP in the short-term. According to the EIA, the relatively small effect "is because the firms most affected … would be relatively large and highly profitable MNEs. These firms are estimated to be less sensitive to corporate taxes in their investment decisions than less profitable firms".[26]

Absent a consensus agreement on the digitalization project, the EIA asserts the baseline would not be the status quo. Rather, the EIA considers four baseline scenarios that assume, alternatively, either narrow or broad implementation of digital services taxes and either proportionate or disproportionate (i.e., five times greater) U.S. trade retaliation and counter-retaliation. Compared to these alternative baselines, a consensus agreement would have a less adverse effect on global investment. Of course, notwithstanding a consensus agreement, there is some risk countries would retain their digital services taxes, particularly those facing large fiscal deficits.

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[25] OECD (2020), *Tax Challenges Arising from the Digitalisation of the Economy: Update on the Economic Analysis & Impact Assessment*, Webcast, 13 February 2020.

[26] OECD, Economic Impact Assessment, *op cit*., p. 21

The investment effects of Pillars One and Two are estimated in two steps: first, by estimating the impact of the Pillars on forward looking EMTRs on cross-border investment, and second by estimating the response of investment to changes in EMTRs.
The estimation of forward-looking EMTRs requires making assumptions regarding: (1) the composition of investment (i.e., the shares of plant, equipment, inventories, and intangible assets); (2) the source of finance at both the parent and foreign affiliate levels (i.e., the share of debt, equity, and retained earnings); (3) the way that multinational companies structure their international investments; and (4) the extent of profit shifting.

The EMTRs in the EIA are calculated using the following assumptions: (1) affected companies are all profitable; (2) investments are financed out of retained earnings exclusively; (3) the pre-tax rate of return required by shareholders is unaffected; and (4) investment is constructed as an unweighted average of non-residential structures, tangible assets, and acquired intangibles. These assumptions are, of course, highly stylized and may often not be representative. Moreover, the EIA disregards: (1) existing CFC regimes; (2) withholding taxes; and (3) most existing tax incentives such as patent boxes, notional interest deductions, and research credits.

The assumed tax sensitivity of investment is based on estimates in a recent OECD taxation working paper that finds the sensitivity of investment to corporate tax rates, for entities that are members of MNE groups with profitability rates above 10 percent (relative to turnover), is about half that of entities that are members of groups with profitability rates between zero and 10 percent.[27] The data on which this research is based is a panel of 26,078 MNE entities located in 17 countries over the period 2007-2016. Notably, this time period almost entirely pre-dates the implementation of BEPS actions as well as the 2017 U.S. tax reform. As highly profitably MNE groups are most affected by the BEPS actions and the related provisions of the 2017 U.S. tax reform, the lower investment sensitivity found for entities that are members of these groups may no longer be applicable.

There are a number of reasons why the adverse investment impacts may be understated, including:

- If the domestic and foreign investment of multinational companies are complementary, as has been found in the academic literature, the investment effects are understated on this account.[28]

- As noted in the EIA, the investment effects are short-run estimates and the long-run effects would be greater.

- The investment effects exclude the potential impact on self-created intangibles, such as patents and know-how, that result from investments in research and development. As the investment of the high-margin companies in scope of Pillars One and Two is

[27] *See*, V. Millot et al. (2020), *op cit*.

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[28] *See*, Mihir Desai, C. Fritz Foley, and James R. Hines, Jr., "Domestic Effects of the Foreign Activities of US Multinationals," *American Economic Journal: Economic Policy* 2009, 1:1, 181–203, http://www.aeaweb.org/articles.php?doi=10.1257/pol.1.1.181

disproportionately attributable to self-created intangible assets, exclusion of this investment is a significant omission.[29]

- The EMTR calculations do not account for many of the investment tax incentives that countries currently provide. Consequently, the impact of Pillar 2 on the EMTR likely is understated and, accordingly, the adverse effect on investment also likely is understated.

In view of the numerous assumptions and simplifications required, the estimated investment effects of Pillars One and Two are subject to at least as much uncertainty as the revenue estimates. However, unlike the revenue estimates, the investment effects are presented as point estimates rather than ranges. It would be helpful to policymakers if, to the extent possible, the Secretariat could indicate the sensitivity of the investment effects to alternative assumptions.

While the EIA and related working papers provide extensive documentation and explanation of the methodology, additional explanation regarding the following points would be helpful:

- No investment effect is shown for countries that do not have corporate income taxes although Pillar Two would increase the effective tax rate on income from cross-border investments in these jurisdictions.

- The investment effects are estimated based on changes in EMTRs rather than Effective Average Tax Rates (EATRs). As explained in the EIA, EMTRs reflect the tax rate on investments that just cover the cost of capital and are used to analyze how taxes affect the incentive to expand existing investments at a given location. By contrast, EATRs reflect the tax rate on investments that earn more than the cost of capital and are used to analyze how taxes affect discrete investment decisions, such as between alternative projects or locations.[30] As Pillar One and Pillar Two both target large multinational companies that earn residual profits (i.e., more than 10 percent of revenues for Pillar One and more than 10 percent of depreciation and payroll for Pillar Two), it is unclear why the EIA estimates investment effects solely using the EMTR indicator (and disregards the EATR).

- The EIA calculates weighted average EMTRs using weights based on investment by all multinational companies rather than just in-scope companies. If in-scope companies systematically differ from out-of-scope companies (e.g., higher investment in intangible assets), this would appear to bias the results.

[29] Pillars One and Two would be estimated to have an even larger adverse investment in self-created intangibles, including R&D, if the Effective Average Tax Rate (EATR) rather than the EMTR had been used in the analysis. The adverse impact would also be larger had R&D tax incentives and patent boxes been taken into account.

[30] OECD, Economic Impact Assessment, *op cit*, p. 215, fn. 8.

V. INDIRECT GDP EFFECTS

While acknowledging the direct effect of Pillars One and Two would reduce global GDP, the EIA identifies four qualitative effects that are said to lead to an increase in GDP. However, as briefly discussed below, the magnitude, as well as the direction of these effects are uncertain.

- **Allocate capital more efficiently**. The EIA states the proposals would lead "to a more efficient global allocation of investment, in the sense that investment would be more likely to be located where it is the most economically productive, rather than in the jurisdictions that provide the most favorable corporate tax treatment." However, use of low-tax investment hubs makes FDI feasible in high-tax countries and thus can contribute to capital export neutrality.[31] Further, if low-tax countries raise their tax rates to 12.5 percent and use the revenues to provide other types of investment incentives, the claimed efficiency gain may not occur.

- **Reduce the intensity of tax competition**. The Report states the proposals "could further support tax revenues in the longer term by reducing the intensity of corporate tax competition between jurisdictions." However, as Michael Keen has shown, preferential tax regimes can *reduce* corporate tax rate competition and measures that restrain preferential regimes, like Pillar Two, thus may worsen tax competition.[32]

In addition, the investment assessment does not account for the reduction in GDP due to the loss in value added from the investment foregone as a result of Pillars One and Two. This omission is of particular concern as the EIA does not account for any reduction in R&D investment, which the academic literature has found is a major source of productivity growth.[33]

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[31] See, Andrew K. Rose Mark M. Spiegel, "Offshore Financial Centres: Parasites or Symbionts?" *The Economic Journal*, October 2017, vol. 117, no 523, pp. 1310-1335, and Dhammika Dharmapala, "Do Multinational Firms Use Tax Havens to the Detriment of Other Countries?" (2020). CESifo Working Paper No. 8275, Available at SSRN: https://ssrn.com/abstract=3598761

[32] See, Michael Keen, "Preferential Regimes Can Make Tax Competition Less Harmful," *National Tax Journal*, vol. 54(4), Dec. 2001.

[33] See, U.S. Department of the Treasury, "Investing in U.S. Competitiveness: The Benefits of Enhancing the Research and Experimentation (R&E) Tax Credit," March 25, 2011, https://home.treasury.gov/system/files/131/Report-Investing-in-US-Competitiveness-2011.pdf