BUSINESS at OECD

20 April 2022

To: Tax Treaties, Transfer Pricing and Financial Transactions Division
Organisation for Economic Cooperation and Development
Centre for Tax Policy and Administration
2 rue André-Pascal
75775, Paris, Cedex 16, France
Submitted by email: tfde@oecd.org

Re: *Business at OECD* (BIAC) comments to OECD's Public Consultation Document "Pillar One – Amount A: Draft Model Rules for Domestic Legislation on Scope"

Dear Secretariat Team,

Thank you for the opportunity to comment on the Draft Model Rules for Domestic Legislation on Scope ("Draft Rules") on Pillar One of the project Addressing The Tax Challenges Of The Digitalization Of The Economy (the "Project"). We provide our more detailed comments in the attached but wish to call particular attention to the following points in our response.

First, in our response to the OECD's Pillar One Tax Base consultation, we emphasized that the calculation of the Amount A tax base should be economically consistent with the goal of identifying an MNE's residual profit from the conduct of its business in the ordinary course. We would like to reiterate this point in the Scope consultation. Our suggested solution to achieving this goal was to exclude all extraordinary income/losses (e.g., gains/losses derived from business disposals structured as asset sales) from the Amount A tax base. By doing this, the concern that extraordinary losses in a single year can cause an MNE to be excluded from Amount A Scope can also be addressed.

More generally, we would like to emphasize the need to keep consistent definitions of revenues and profit before tax across all Pillar One building blocks, and that our comments be considered across building blocks where applicable. For example, we had commented that the definition of revenue should mean top-line net revenues per the relevant financial accounting standard – that comment should also be considered for the Scope consultation. The definition of joint ventures and treatment of income not earned by shareholders (i.e. the share of consolidated group income attributable to minority shareholders) should also be consistent across all building blocks.

Second, the draft Scope rules make reference to both a "prior period test" as well as an "average test" in measuring the historic and recent cumulative level of profitability of the Group for purposes of determining whether it is in scope of Amount A. These scoping tests address some but not all concerns arising from the absence of a profit shortfall mechanism in the measurement of Amount A. As expressed in separate commentary on the draft tax base consultation, in principle, we believe that profit shortfalls should be reflected in the measurement of Amount A to ensure that countries where entrepreneurial activities of the Group are otherwise located earn at least a normal return on a cumulative basis before Amount A is applied. These averaging tests in the draft Scope rules may not adequately address this issue since they don't fully take into account a Group's complete history of losses and profit shortfalls in years prior to generating an excess annual return.

Our primary recommendation remains that profit shortfalls be addressed in the measurement of the tax base. We also recommend that these averaging tests be applied on a rolling basis and extended to also apply for purposes of the scoping criteria for revenue. And finally, absent a profit shortfall remedy in the measurement of the tax base, we further recommend that the Task Force consider extending the number of prior years included in the "average test." We believe these changes serve to better ensure that Amount A is only applied after all members of the Group earn a normal return on a cumulative basis.

Third, the draft Scope rules reference pending guidance on both an "Extractives Exclusion" and a "Regulated Financial Services" exclusion, as well as reserving paragraph 6 for "exceptional scope rules for determining when a disclosed segment" is in scope of Amount A. Having just received the release of the "Extractives Exclusion," and while we await release of these other remaining draft scoping rules, we also continue to encourage the Task Force to provide for a domestic business exclusion. In particular, we believe an elective exclusion is warranted in those circumstances where businesses either have decentralized business models with local entrepreneurs or do not operate in a unitary fashion globally. In those limited circumstances, a domestic business exclusion is necessary to preclude a profit reallocation to market countries for amounts well in excess of 25% of residual profits from sales into those markets, and also to avoid the scenarios where there will be multiple market countries relieving Amount A taxes to other market countries

We thank you for the opportunity to comment. We would be pleased to respond to any questions arising from both our general and specific comments provided, and to providing further support and assistance in implementation efforts to follow.

Sincerely,

Alan McLean
Chair, *Business at OECD* (BIAC) Tax Committee

William H. Morris
Chair Emeritus

Cc: Hanni Rosenbaum, Executive Director, *Business at OECD* (BIAC)

Our detailed comments are provided below:

1. Questions/comments sought by the Secretariat

Section	Topic	Issue	Recommendation
Title 2 – Article 1, 2(a)	Total Revenues of a Group	Whether the Total Revenues of a Group should be subject to equivalent rules as the prior period test and the average test (which apply to profitability)	We recommend that Total Revenues of a Group should be subject to equivalent rules (similar to the tests applicable to profitability).
Title 2 – Article 1, 2(b) & FN 5	The test should not be an entry test	Implementing a 3-tier test to scope indicates a policy rationale that groups should only be in scope if they have a sustained profitable situation. Transforming this into a "once in, always in" test is as random as looking at a single year for scoping purposes, all the more so given the inconsistent adjustments to Total Revenues (see below).	• The use of the 2(b) test on a rolling basis is a better answer as it addresses cyclical businesses and changing profit margins on an ongoing basis to only apply Pillar One to consistently highly profitable businesses and minimizes the impact of extraordinary gains dragging companies into Pillar One compliance when they are not regularly earning over 10%. • The policy rationale of only having in scope group with a sustainable profit level should be respected given the undue administrative burden of being in scope (having to prepare returns since it is most likely that group not in a sustainable profit situation for scoping purposes will not have any Amount A). • The argument against a rolling test is that one off losses incurred in a given year should not trigger the exit of the scope for a number of years as a result of the averaging. However, this concern could be addressed by excluding extraordinary items from the profit before tax measure – consistent with our comments on tax base. • We note that the determination of tax base (wave 2) and the pre-tax profit margin (this wave 3) are not entirely consistent. In a logical world they should be aligned. However, we assume that simplification is the explanation.

Section	Topic	Issue	Recommendation
Title 2 – Article 1, 7 & FN 11	Preparation of QFAS when getting close to the scope	Language in the article is far too wide and does not match the intent disclosed in footnote 11. The intent practically means that all groups would have to do QFAS just for the purpose of determining if it is in scope. This is generating undue burden on group far beyond the targeted top 100.	We suggest that the OECD provide trigger points that would indicate that past these trigger points of revenue and profitability in the relevant non QFAS standard, a group needs to produce a QFAS to test whether they are in scope of P1. The trigger points should be set in such a way that it is virtually certain (based on accounting differences between the relevant non-QFAS standard and the QFAS) that a group would be in scope of P1. Such safe harbour provisions need to be very clear and respected by tax administrations – otherwise the burden of proof will always be on the taxpayer to prepare accounts merely to prove that they are not in the regime anyway. A member suggested that the threshold test could be within 10% of EUR 20/10 billion.

BUSINESSatOECD

2. Additional Comments

Section	Topic	Issue	Recommendation
General		The average and prior period tests address some but certainly not all concerns arising from the absence of a profit shortfall mechanism in the measurement of Amount A.	We believe that profit shortfalls should be reflected in the measurement of the Pillar 1 tax base to ensure that countries of principal locations (payer entity countries) earn a normal return on a cumulative basis before Amount A is applied. Please see earlier comments made to the Tax Base rules that suggests adding an under-profit (or shortfall) carryforward to mitigate timing issues with recognition of above and below 10% profits in different years. The averaging and prior period tests in the Scoping rules do not fully address this need, since they don't take into account a company's complete history of loss and profit shortfalls prior to earning excess returns in a single year.
General		There is no mention of a domestic business exclusion as contemplated by the Pillar One Blueprint.	While we understand that additional scoping guidance is expected concerning financial institutions, extractives, and select cases of segmentation, we are concerned that the TFDE appears to have otherwise abandoned consideration of a domestic business exclusion. We believe that such an exclusion is also warranted, at least in certain circumstances where businesses do not operate in a unitary fashion globally, including decentralized businesses operating through local entrepreneurs. In these instances, an elective domestic business exclusion appears warranted to preclude a profit reallocation to market countries for amounts well in excess of 25% of residual profits from sales into those markets, or the scenario where multiple market countries will be relieving Amount A to multiple other market countries.
General		Certainty will be needed by some MNEs that are not in scope to avoid inquiries being opened in multiple jurisdictions.	We would welcome further measures in relation to providing certainty as to whether a taxpayer is in scope of Amount A through the use of the dispute prevention and resolution framework previously set out in the Pillar One blueprint which establishes a review panel. The framework should include guidance on the resolution of disputes in relation to the scope of Amount A so as to avoid double taxation in the event of a tax dispute. A multilateral

Section	Topic	Issue	Recommendation
			binding dispute resolution mechanism remains critical to eliminate double taxation. The scope review should cover issues such as the calculation of total revenues and PBT margin, excluded revenues, and segmentation.
Title 2 – Article 1, 1	Covered Group	It is not clear whether Excluded Entities are excluded from the Covered Group tests.	The scope rules should clarify that Excluded Entities, including Investment Funds, be excluded for purposes of the Covered Group tests.
Title 2 – Article 1, 2(a)	Adjustment for revenue threshold for periods longer or shorter than 12 months	The adjustment is done proportionally. This may be a simplification measure for Groups that cannot provide more accurate data but could in theory create distortions is case of significant sales volatility or one-off transactions (especially for periods longer than 12 months).	Actual revenues for the periods longer or shorter than 12 months should explicitly be allowed. The proportionality principle should be an option for the group to use in case it cannot provide more accurate data.
Title 2 – Article 1, 2(b)	Period used for calculating pre-tax profit margin	Using only 4 prior years is inconsistent what are generally longer loss carry forward periods allowed by OECD countries.	It would be more logical to look at cumulative history, or if not, to align this with loss carry forward period. We recommend extending the period from 4 to at least 10 years to be consistent with the loss carryforward period.
Title 2 – Article 1, 2(b)	Currency fluctuation issues for revenue	The Secretariat acknowledges that "the revenue threshold is currently denominated in a single currency in line with the Statement. This raises a number of coordination issues related to currency fluctuations…"	Recommend to clarify the mechanism to calculate the numeric threshold in the global revenue test. For example, an index could be produced each year that shows the cumulative change of major currencies against the Euro starting in the year of commencement of Pillar One. This would however imply that the same FX rate is used for the first prior period calculations as a simplification.

Section	Topic	Issue	Recommendation
			To mitigate the impact of unusual currency fluctuations, we recommend that average annual exchange rates be used (i.e. measured on at least on a quarterly, if not monthly basis) to convert foreign currency denominated revenue into the Euro.
Title 2 – Article 1, 4	Extractive Activities or Regulated Financial Services exclusion	Key provisions relating to the Extractive Activities or Regulated Financial Services exclusion are outstanding	Given that the Pillar 1 Model Rules on Scope are intended to work in tandem with the exclusion provisions, it would be important for us to have the opportunity to revisit and comment on the Model Rules on Scope prior to their finalization, when details on the exclusions become available.
Title 2 – Article 2, 6	Placeholder for segment scope rules	The question can come up whether the prior period test and the average test should also apply in respect of a disclosed segment.	Recommend that the prior period test and the average test should also apply in respect of the exceptional scope rules for determining when disclosed segment is in scope of Amount A (art. 2 para 6).
Title 9 – Definition of Total Revenues (a)	Exclusions from revenues	Dividend income or equity or asset gains are typically not included in revenues under IFRS. Including them as exclusions without further explanations may cause confusion.	The adjustment, if needed, should relate to revenues that are recorded as net revenues/sales/turnover per a group's audited consolidated financial statements (see our comment on revenue sourcing).
Title 9 – Definition of Total Revenues (a)	Exclusions from revenues	As already mentioned in the answer to the draft rules on the Tax base determination, we see no reason NOT to exclude gain/losses from a sale of business performed as an asset deal. Therefore the associated revenues should also be eliminated	In line with previous recommendations related to "tax base determination" it is recommended that if applicable, revenues should be adjusted to remove distorting effect of one-off items such as the gain or loss that can arise in the of the disposition of a business, whether in the form of the sale of equity interests or in the form of the sale of assets.
Title 9 – Definition of Total	Adjustments for restatements	It is unclear how the Eligible Restatement Adjustment will apply to revenues if applicable.	Clarify whether Eligible Restatement Adjustment for revenues can also not exceed 0.5% of Revenues of the Group in the Period, or if the threshold is larger.

Section	Topic	Issue	Recommendation
Revenues (c)			Also see our earlier comments on expanding the restatement cap.
Title 9 – Definition of Total Revenues	In general	n.a.	The OECD should ensure that revenues and profit before tax after making all adjustments (e.g., share of JV revenues/profits) should be aligned across all building blocks of Pillar One (e.g., revenue sourcing, tax base, scope, and any others). We also encourage consistent definitions, where appropriate, across both Pillar One and Pillar Two.
Title 9 – Definition of Average	Point b related to Group demerger on page 12	The draft rules propose a formula for calculating the total revenues of the demerging group for the purpose of the averaging of the profit over prior periods. We don't fully understand the rationale of the proposed formula	We suggest to clarify the intent of the formula using an example with figures.
Title 9 – Definition of Joint Venture	Definition of Joint Venture	It is not clear what is the intended meaning of "joint control" – for example, an MNE has a 50:50 JV where it does not control, so its JV partner consolidates 100% and the MNE equity accounts for 50%. Is that the scenario envisaged here, or is it only targeting the relatively narrow scenarios where there is a 50:50 JV where neither controls and both parties equity account for 50%?	We would like this issue to be further explained. We would also like to receive further clarification on why revenues and profits from such JV should be taken into consideration for the global revenue test that is coherent with the group entity and the UPE definitions. Where there is a 50:50 JV where neither party controls and both parties equity account for 50%, the same treatment for profits/losses accounted under the equity method should apply. Also, under this rule (and the tax base rule) only a proportionate (50%) share of Revenue is adjusted in the MNE's financials for purpose of Pillar One. Yet, it appears that no adjustment is made in a case where there is control (consolidation) with a minority interest. Thus, you have a strange result that in a 50% owned JV, 50% of the results are included but in a 51% (or more) owned JV you have 100% included. This is not logical. Similar proportionate rules should apply to Controlled JV's.

Section	Topic	Issue	Recommendation
Title 9 – Definition of Acquiring Group	Definition of Acquiring Group	There is no consideration of materiality in this scenario and whether or not it is reasonable possible to obtain information that is in line with the group accounting policies under qualifying financial accounting standards. Itt could be an administrative burden to recalculate prior year information to calculate the average of the global profit test when an acquisition occurs.	Recommend to include a materiality consideration (e.g., an acquisition that results in more than 25% increase in Group revenues).
Title 9 – Definition of Excluded Entity	Definition of Excluded Entity	The "or" 5% threshold test (i.e., ownership and activities) that is in Pillar Two is not included in Pillar One.	We recommend consistency in the definition of Excluded Entity across both Pillars. Most of the other definitions such as for Investment Fund are identical to those in Pillar Two. The same policy rationale should apply across the two Pillars. This could cause some MNEs to come within scope of Pillar One because of the inclusion of Investment Funds (which may not, themselves, be included in the Regulated Financial Services exception) where just the 95% threshold test cannot be met, thereby inflating both the MNE revenue and profitability thresholds. The concern is compounded for these thresholds if there is a "carry" in which an asset manager's employees share in the Entity's profits. The inclusion of the first 95% threshold and not the second 85% threshold from Pillar Two is not an unnecessary expansion of Pillar One's exclusions. Instead, it acknowledges that there may be commercial reasons, such as "carry", for which Amount A should not be applied.
Title 9 – Definition of Government Entity	Definition of Government Entity	Only wholly governmental owned entities should fall within this definition.	The scope of "business" can be very wide (See the case law reviewed in *G E Financial Investments v Revenue & Customs* [2021] UKFTT 210 (TC) [72] to 80]. This definition should be clarified to say that the trade or business is carried on with a view to profit. The meaning and scope of "government function" is

BUSINESS at OECD

Section	Topic	Issue	Recommendation
			not at all clear and may vary considerably particularly according to political views. The purpose should be "exclusively" (see the definitions of pension fund and non-profit organisation) for governmental functions. Its income and assets should be applied exclusively for that purpose (see the definition non-profit organisation). We would also suggest that (b) should be divided into two separate tests between trade/business and government function to make clear that these are part of the cumulative test. Otherwise, this definition may allow for very big groups to escape the charge or give rise to disputes that are difficult to resolve.