29 April 2022

To: Tax Treaties, Transfer Pricing and Financial Transactions Division
Organisation for Economic Cooperation and Development
Centre for Tax Policy and Administration
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Submitted by email: tfde@oecd.org

Re: *Business at OECD* (BIAC) comments to OECD's Public Consultation Document "Pillar One – Amount A: Extractives Exclusion"

Dear Secretariat Team,

Thank you for the opportunity to comment on the public consultation document "Pillar One – Amount A: Extractives Exclusion" (the "Document"). We provide our more detailed comments in the attached but wish to call particular attention to the following points in our response.

- We support the exclusion for Extractive Activities and its policy goal of excluding the economic rents generated from location-specific extractive resources that should only be taxed in the source jurisdiction. Achieving this outcome is the primary driver in our response, with minimising administrative burden for relevant MNEs and resource-rich jurisdictions as a vital but secondary aim.

- Achieving this objective requires a careful framing of the rules to ensure that profits from Extractive Activities are not inadvertently allocated to market jurisdictions under Amount A as a consequence of the delineation mechanisms. We agree with the policy statement in the Document that outcomes in respect of the in-scope activities undertaken by the Group should equate to the outcomes of a standalone business separate from the extractives part of the Group – this would ensure appropriate outcomes under Amount A and a level playing field with Groups that are not engaged in Extractives Activities but are engaged in similar in-scope activities. We recognise though that there may be administrative simplifications that could achieve this outcome in many cases without having to undertake and audit detailed calculations, and we endorse these if they can be achieved while respecting the broader policy objectives.

- Specifically, where there is a delineation point between excluded Extractives Activities and Amount A in-scope activities within an integrated supply chain, how in-scope revenue is calculated for the purposes of determining the profit margin under Step 3 is a critical issue. This rule for that calculation must be framed both to ensure there is not an artificial inflation of the profit margin of in-scope activities, as well as ensuring that excluded revenue is inadvertently included. Where this is not achieved, the consequence will be disproportionately high reallocations under Amount A, including reallocations of profits from Extractive Activities notwithstanding the policy underpinnings of the exclusion. We have provided examples in our detailed comments demonstrating this concern and would welcome an opportunity to provide additional input to ensure the policy objectives of the exclusion are achieved.

- The Document seeks to apply “predominance tests” to segments/entities. This is in order to identify which segments/entities are truly mixed and must have their profits bifurcated between in-scope and excluded, and which segments are predominantly excluded Extractive Activities with only incidental revenues (or deemed revenues) related to in-scope activities. We strongly welcome the approach of using a percentage-based threshold of extractive revenues in order to alleviate the administrative burden of splitting segments/entities that involve predominantly Extractive Activities and revenues. We believe that a fixed monetary threshold (suggested to be EUR 1 billion) is unnecessary where the percentage test is set appropriately high and note that over time it could cause significant challenges as inflation reduces the relative value of this monetary threshold. We therefore recommend that the fixed monetary threshold is removed, and the percentage-based threshold be set at a level that can give delegates comfort that a very significant proportion of extractive revenues is required in order for the exclusion to apply to an entity/segment. We would be happy to have a follow up conversation with the Secretariat and TFDE members to understand the delegates’ concerns on this topic and to offer further refinements to this solution.

- We accept that a consequence of the exclusion for Extractive Activities is the need to bifurcate the financial results of the Group between in-scope and excluded activities. This will involve significant complexity and may require extensive systems (ERP) changes to undertake the necessary analysis and compliance. We support the suggestion in the paper that an initial transition period is necessary to enable Groups to adjust their systems to comply with the requirements. In addition, we believe the proposal would greatly benefit from additional simplification, and we have offered several suggestions in our detailed comments.

- Finally, we are concerned at the suggestion in para 3 that the “exceptional segmentation rules” should apply in addition to the extractives exclusion. We consider this an additional administrative burden that for extractive groups will not produce an outcome more aligned with the policy objectives. It is not clear how these rules would work in practice. But we note the extractives exclusion does, in any event, require detailed segmentation. Therefore, we consider the policy objectives are best met through using them to look at the whole of in-scope extractives groups and bifurcating revenues/profits accordingly as per Steps 2 and 3 to ensure that the right revenues/profits are in-scope.

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	William H. Morris
Chair, *Business at OECD* (BIAC) Tax Committee	Chair Emeritus

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

Our detailed comments are provided below:

Para	Topic	Issue	Recommendation
3	Step 1 application of general scope rules	Paragraph refers to "or a disclosed segment (where the exceptional segmentation rules apply)".	We would like to confirm that the "exceptional segmentation rules" would not apply to the Extractives industry. Where segmentation applies, we understand that in-scope segments/portions would be combined (see paragraph 41) so that a Covered Group will ultimately only have one consolidated in-scope segment for which to calculate Amount A.
4	Step 2 revenue threshold test	n.a.	As a simplification mechanism, very large MNEs with consistently high revenues should be able to move straight to step 3 without running the revenue test year on year. We suggest adding an annual simplification election for MNEs to bypass step 2.
5	Step 3	The extractives industry is in a unique position in respect of the P1 rules in that not only will it have the base complexity relevant to the P1 rules, it will have additional complexity associated with the fact that the industry will be required to bifurcate its accounts between excluded and in-scope revenue/ profits/ costs etc.	Paragraph 5 notes ongoing work related to simplification where the in-scope profit margin is consistently below the 10% profitability threshold. This paragraph also notes the possibility of an initial transition period to enable Groups to adjust systems. Every effort should be made to find simplification solutions, particularly in respect of Step 3. Compliance with the requirements may require extensive systems changes which are both time consuming and very costly. A transition period will provide much needed time for those groups to implement the rules in an orderly, accurate and auditable manner. See transition period proposals we outlined in our response to the Revenue Sourcing consultation. We would also be happy to discuss with you simplification methods that can be applied specifically to the Extractives industry during the transition period. Significant system challenges can also be brought on by the differences between group and local accounts. We suggest allowing for elective use of local accounts to provide taxpayer optionality depending on their ERP set up.

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			Commentary with implementation guidance should also be released for public consultation so that stakeholders can provide their input and views.
3, 4 and 5	Scope	To be in scope means ... "has more than EUR 20 billion of Revenue" and "a profit margin above 10%"	We recommend using a multi-year averaging scope requirement, to avoid one-off years in an industry that is subject to commodity price swings, while also focusing on highly profitable taxpayers. See our comments to the Scope consultation. Additionally, absent this averaging, taxpayers may find themselves subject to a laborious compliance requirement that generally would not be applicable, and with limited time to implement.
7	Step 5	While not directly covered in this paper it will be necessary to confirm the allocation methodology applicable to the extractives industry.	Confirm the allocation methodology relevant to the extractives industry.
12	Extractive Activities definition	Revenue from performing extraction services only (without owning the extractive product) will not qualify for the exclusion. The Group must have carried out the Exploration, Development or Extraction	It is common in some oil and gas extractive contracts e.g. production sharing contracts (PSC) and/or Technical Services Contracts (TSC), for the Group to operate as a contractor to the host country but may not own the resource. Instead, it is granted rights to exploit, extract and develop the resource (and sometimes share in the production from the resource with the host country) under the extractive contract. Such contractual arrangements should qualify as Extractive Activities and this should be confirmed in the Commentary. It is also common for Groups to participate in Joint Ventures (JV's) and PSC's as a non-operating member. It would therefore not have directly explored, developed or extracted the resource. The Extractive Activities definition should cater for such situations, for example by explicitly confirm that participation in a JV or PSC as a non-operating member will qualify as an Extractive Activity.
12	Dual Test	It is unclear how the dual test (i.e., product test and activities test) would apply in the LNG context where there is both supply of	In some cases, third party gas is required as feedstock to fill the capacity of the liquefaction train. It would be very complex to separate liquefaction margins for third party gas vs equity gas. We propose to treat the processing of third-party gas into LNG as an extractive activity.

Para	Topic	Issue	Recommendation
		feedstock from extraction as well as third party gas.	Please also refer to our comment on paragraph 17&18: Definitions of "Extractive Activities" and "Extractive Product" which is based on the same principle.
12 - 15	Step 2 – application of Revenue Threshold	Para 12 indicates that the test is applied by "taking the consolidated Group revenue figure and subtracting third party revenue derived from Extractive Activities". Para 14 goes on to say "However it is recognised that because of the design of the definition of Extractive Activities…… there may not be identifiable third party revenue…." In this instance para 14 indicates that Groups would proceed to Step 3.	We agree that due to the nature of the definition of "Extractive Activities" the delineation point will in many instances (most notably where para 27(b) applies but also where 27(c) or (d) apply) be at a point where there is no third-party revenue. We agree that a 'shortcut' which enables the group to proceed directly to Step 3 is a useful simplification mechanism to remove the additional compliance associated with Step 2 for those groups which will not meet the threshold for Step 2 and will need to proceed to Step 3 in any event. We agree with the comments made in para 15 on the consequences that would arise if the group was required to identify revenues at the granular level. For many/most groups they will have a number of delineation points which will likely be a mix of delineation points where there are third party revenues (ie because the delineation point is at the sale to a third party) and where there are not third party revenues. Para 14 appears to suggest that where a group has a delineation point at either 27(b), (c) or (d), the group would proceed to Step 3 where a group has NO third-party revenue at any of the relevant delineation points. There would be very few instances in practice where this would be relevant in our experience. As noted above, it is more likely to be the case that the group will have a mix of delineation points where there is both third party revenue and non-third-party revenues. Clarity is therefore required on the circumstances in which a group can move straight to Step 3. Depending on the fact pattern of the relevant group, a group may have sufficient third-party revenue at the delineation point such that an

Para	Topic	Issue	Recommendation
			application of Step 2 results in satisfaction of the Step 2 threshold – i.e., there is no need to proceed to Step 3. This may be the case even where there are additional delineation points relevant to the group where there are no third party revenues (e.g., the majority, but not all, of delineation points for that group involve third party revenue). Significant simplification could be achieved in this scenario if groups can apply Step 2 even if they have some delineation points which do not involve third party revenue (e.g., under 27 (b-d)). For example, if a group has mostly third-party revenues (e.g., 75-85% as outlined in Paragraphs 37-39), then it can also apply Step 2. The simplification comes from the removal of the requirement to apply Step 3 if the Step 2 threshold can be met. On the other hand, a group which has a weight of delineation points that do not involve third party revenue will receive simplification benefits from being able to skip Step 2 and proceed directly to the more granular, and arguably more accurate, analysis under Step 3. This approach of removing the mandatory application of step 2 would provide significant simplification benefits.
18(c) and note 6	"Extractive Product" includes "a license to explore for or exploit Minerals, Mineraloids and Hydrocarbons"	Note 6 indicates that 18(c) will explain that this will include licenses granted by the State, by a private person that owns the natural resource, or the transfer of rights between two companies. In some instances the group will hold a beneficial interest in the licence rather than a direct proprietary interest. This can arise where the licence is granted by the State but where the State grants beneficial interests in the licence via the State Agreements or similar. It can also arise in circumstances	The model rules should confirm that 18(c) applies to beneficial interests in a licence to explore for or exploit Minerals, Mineraloids and Hydrocarbons.

Para	Topic	Issue	Recommendation
		where a company holds the licence and the admission of a JV partner results in the granting of a beneficial interest in the licence to the incoming JV party but not a direct legal interest as tenants in common (or similar). This may be necessary because of restrictions under local Mining Regulations.	
18	Definition of "Extractive Product"	Extractive product is defined to mean "any solid, liquid or gas that is extracted from the earth's crust."	We agree with the definition however recommend the commentary confirms that salt or other minerals which are produced from evaporating seawater as opposed to being mined as a solid material also falls within the definition of an Extractive Product.
17 & 18	Definitions of "Extractive Activities" and "Extractive Product"	The definition of "Extractive Activities" is defined by reference to "the Group". There are a number of uncertainties associated with this: 1. The term "Extractive Activities" is also used in the application of Step 3 which is looking at individual entities and/or segments. Is it correct that the definition for the purposes of Step 3 is by reference to the activity at the group level? 2. What is the outcome in relation to blending where a group may purchase third party material to blend with its own material to create, for example, a grade which is more marketable to customers? 3. What is the outcome where there is a UJV where each JV partner takes title to their share of the extracted material however one JV party (A Co) chooses to	Consider the definition of "Extractive Activities" in this context. We do not see anything in the paper which suggests that a group which is undertaking Extractive Activities but which also purchases material from another party (related or non-related – e.g., either for blending or per the JV example we have provided) as an input into that activity is required to bifurcate revenues. We believe this is appropriate and note that to do so would involve a significant compliance burden and likely unintended consequences. Material purchased in these circumstances is merely an input cost to processing one's own product. An integrity rule based on volume or costs could be considered however we don't believe this could reliably be used to split the revenues into excluded / in-scope. Please also refer to our comment on paragraph 12: "Dual Test" which is based on the same principle.

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		sell its share of its material to another JV party (B Co) who may own, for example, the processing facility for the next stage of the process? In this instance, the delineation point for A Co is the sale to B Co. Is the revenue earned by B Co on the sale of the material to the end customer eligible for the carve out (subject to the tests in para 25)? This point is similar to the blending point above.	
17, 18 & 25	Dual test for hydraulic binders products. Definitions of "Extractive Activities" and "Extractive Product".	Para 18 a) clearly includes limestone which is the main component of hydraulic binders (e.g. cement) as an extractive product. However, there is a need to clarify the interaction between Para 18 b), Para 25 and 25 b).	The production of hydraulic binders consists firstly of extracting limestone rock, secondly on the crushing/refinement of the limestone followed by burning into a liquid which solidifies into the mineral clinker. The clinker is lastly blended and grounded to become a hydraulic binder being a basic commodity. This process is very similar, although simpler, to the casting of metals. We therefore recommend that the Commentary specifies that blending is a Qualifying Processing and that Para 25 is changed as follows: "Qualifying Processing means processing undertaken to concentrate, isolate, purify, refine, liberate or <u>**blend**</u> an Extractive Product". That would confirm that limestone and clinker as well as any product that is the result of the blending of any solid, liquid or gas that is extracted from the earth's crust is an extractive product. We would also recommend clarifying Para 25 b) as noted below.
22	Definition of "Exploration"	Para 22 defines "Exploration" means the process of searching for and assessing an Extractive Product resource deposit or reservoir	We recommend a slight terminology change as follow to align with common industry parlance. "***Exploration***" means the process of searching for and ~~assessing~~ *evaluating* an Extractive Product resource deposit or reservoir

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23	Definition of "Development"	Para 23 limits "development" to construction of E&E facilities and supporting infrastructure.	We recommend to also include activities related to the maintenance/upkeep of such facilities and infrastructure (as long as the same Group was also responsible for the construction of such facilities).
24	Definition of "Extraction"	"Extraction" means the removal of an Extractive Product from its natural site or from mine tailings and includes the Qualifying Processing and Transportation of such Extractive Products.	We recommend to also include storage of extractive product necessary to maintain such until transfer to a third party.
25	Definition of "qualifying processing"	Qualifying Processing includes transformation and processing of hydrocarbons into a liquefied state, including liquefied natural gas (LNG) and liquefied petroleum gas (LPG); processing of bitumen from oil sands, oil shale and heavy oil to a stage that is not beyond the crude oil stage or its equivalent	We recommend to also include storage of such hydrocarbons necessary to maintain such until transfer to a third party
25(b)	Definition of "Qualifying Processing"	Qualifying Processing for mining and metals includes activities which result in the production of minerals, mineraloids and metals including the casting of metals	We agree with this definition in general but note that the term "production" may carry some unwelcome connotations with respect to domestic tax codes. The term "winning" is preferred to avoid this. It would be helpful to confirm that the definition of casting includes casting into various generic shapes and products and this is not classified as extrusion or fabrication.
25(c)	Definition of "Qualifying Processing"	Qualifying Processing does not include extrusion, fabrication or activities to produce alloys, steel, jewellery, petrol, gasoline, diesel, kerosene and similar refined hydrocarbons, lubricants, chemicals, plastics and plastic polymers	An "alloy" is simply a mixture of metals, or a metal combined with one or more other elements. There are different types of "alloys" in the minerals/metals industry. In some cases, the "alloy" is a distinguishable product that is formed from the process of combing one metal with one or more other metals or

Para	Topic	Issue	Recommendation
			elements to form a different kind of metal. For example, copper is combined with tin (and other metals such as aluminium, manganese, nickel or zinc) and sometimes non-metals or metalloids such as arsenic, phosphorus or silicon, to create bronze. In other cases, the underlying metal has additional elements added to it to make that metal more marketable, but the resulting product is still the same underlying metal. An example is where primary aluminium has other elements such as copper, manganese and silicon added to provide additional strength, corrosion resistance and other properties. The resulting output is still the same metal, i.e., aluminium, and is still priced by reference to the same index (LME), but with a premium paid by customers for the quality of the product. Most aluminium smelters produce a combination of base or primary aluminium and value-added aluminium which has the additional properties (strength, etc.). A requirement to bifurcate the activities undertaken in the aluminium cast house to strike a delineation point where the addition of the elements occurs (which is technically activities related to an "alloy") will create significant complexity and additional compliance. Similar issues are relevant to the production of platinum group metals and many other extracted products that would ordinarily qualify for the regime and we believe be expected to qualify under ordinary parlance (i.e. where trace or small percentages are added as part of processing). Therefore we recommend that the term "alloy" is removed and reliance be placed on the specific exclusion of policy intended in-scope activities: for example we understand there is an express policy that steel be in-scope. If this is not acceptable, other approaches which provide other delineation references to narrow the application of the word "alloy" should be used – e.g., either percentages or express inclusions or definitions which link to the character of both the base metal and the resulting alloy. This may result in

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			some complexity and additional compliance due to differences with domestic laws and customs codes but would at least provide certainty.
26	Definition of "Transportation"	"Transportation" means the physical movement and incidental storage of an Extractive Product to the delivery location to fulfil delivery terms set out in sales contracts and includes physical movement by airplane, automobile, helicopter, pipeline, ship, train, or truck. We believe this definition would benefit from some additional clarity.	We recommend consideration of the following definition: "Transportation" means "any transport including air, land and sea freight as well as storage connected with the underlying extracted product". It is common also for insurance terms related to physical shipping to be agreed as part of the sales contract. Needing to strip out the insurance element of each transaction would be very onerous. Therefore, to the extent that insurance is priced into third-party or intercompany agreements, taxpayers should not be required to separately carve out the value associated with insurance and should be able to use the contractual price as is. We also recommend clarifying (perhaps in the Commentary) that Transportation would include all activities to ready extractive products for sale, regardless of whether there is an instant sales contract for the particular products. This is especially necessary if the individual molecules are not being sold and identification would be problematic.
26, Note 8	Definition of "Transportation"	Note 8 indicates: "The Commentary would explain that the reference to 'the delivery location to fulfil delivery terms set out in sales contracts' reflects that transportation of an Extractive Product to market can either be performed by the producer or the customer. Where the transportation is performed by a producer and set out in the sales contract, the revenues earned for the transportation are included within the calculation of the extractive exclusion, and	It is not clear to us what the policy intention is in relation to transportation, particularly the reference to "notwithstanding that the Delineation Point may have been triggered". We would welcome a discussion on this to understand this further with a view to assisting in the drafting of this element. It is common practice for groups to operate centralised shipping and logistics functions which may undertake shipping activity in support of CFR arrangements or directly with third parties or in support of internal integrated supply chains.

Para	Topic	Issue	Recommendation
		notwithstanding that the Delineation Point may have been triggered."	
27(a)	Determination of the "Delineation Point"	"Where there is a sale of the Extractive Product made from the Group to an Independent Party". Note 9 indicates that 'sale' means a transfer of title	We agree that tolling arrangements are not a "sale" for the purposes of 27(a) on the basis that there is no transfer of title. This is an important clarification given the prevalence of tolling arrangements in the industry.
27(a)	Determination of the "Delineation Point"	"Where there is a sale of the Extractive Product made from the Group to an Independent Party".	We assume for the purposes of this sub-para the relevant revenue amount for the purposes of excluded revenue and for applying the profitability test is the net sales/turnover as reflected in the financial statements.
27 (b) + Note 10	Determination of the "Delineation Point"	"Where there is an Intra-Group transaction transferring the Extractive Product from the State where the Extraction takes place to another State". Note 10 indicates that 'transferring' is used to capture instances where there is no actual intragroup sales contract.	We agree that where there is a physical transfer of the extracted material from State A in which the extraction occurred to State B (e.g., for process) breaks the nexus to the policy justification for the carve-out. We assume the use of the word "transfer" rather than sale is to prevent a group circumventing the delineation point by simply not selling the material to an entity in State B – e.g., an entity in State B undertakes processing on an agency basis or on a tolling basis. We recommend that this be clarified to confirm this relates to a physical transfer of the Extractive Product from the State of Extraction to another State.
27 (b)	Determination of the "Delineation Point"	"Where there is an Intra-Group transaction transferring the Extractive Product from the State where Extraction takes place to another State."	Arm's length intra-group prices used by an MNE should be respected in the determination of the profit margin – for example in an integrated supply chain where the in-scope business has acquired the extracted material for further processing.
27(c)	Determination of the "Delineation Point"	Delineation point where there is an "Internationally Recognised Reference Price"	There is an emerging prevalence of the use of indices in the extractive industry. Expansive additional guidance is necessary to provide certainty over the application of para 27 (c) and the circumstances where there is an "Internationally Recognised Reference Price".

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			Indices are largely used as a price discovery tool or to inform indicative pricing. The starting point for pricing is based on market and trade publications information or indexes such as WTI, Alumina, ICE Brent, with a premium or discount to account for several factors (location, transportation and most importantly quality). In some cases, pricing is not directly dictated by an index but by reference to an index. For example, the emerging Alumina index provides an indicative price per tonne for alumina however the price actually paid by customer will reflect the contractual arrangements between the parties. Similarly for oil and gas products, an international index is used as the basis for pricing, with products trading at a premium or discount to the index price. For example a barrel of West Africa crude may be a Brent-indexed priced barrel but because the product doesn't possess the exact quality characteristics of Brent e.g. sulphur and gravitational content is higher than Brent, it will trade at a 'Brent minus' price. Often the differentials are themselves internationally recognised. Even where there is a reference in the contracts to the index price, the adjustments agreed for things like marketing costs, purity, location etc. can be material. We recommend additional clarity be provided – for example: "Where there is an Internationally Recognised Reference Price used for pricing the Extractive Product, the Extractive Product meets the specifications established by the Internationally Recognised Reference Price and the Extractive Product is capable of being traded on the relevant index".
27 (c) FN 12	Determination of the "Delineation Point"	Commentary will offer an explanation of 'meeting the specifications' for the International Recognised Reference Price.	We are unclear on the example used FN12. It is very possible that gas produced outside the US may use e.g. Henry Hub as its index price. It is also common for crude oil produced in many countries to use Brent, WTI or other indexes as a price reference point for the product. We recommend additional clarity be provided on the circumstances when 27(c) is expected to be relevant.

Para	Topic	Issue	Recommendation
27 (d)	Determination of the "Delineation Point"	Fall back delineation point (i.e., where the backstop applies) deemed revenue amount is MV of product x quantity. How is market value to be determined in this instance?	We need to avoid where possible the need for external/independent valuations given this is not a moment in time valuation (e.g., as would be the case for determining the MV of an asset at a point in time in a transfer). In many instances this will be an ongoing issue – e.g., the day to day determination of the MV of aluminium at the point in the cast house where 25(c) is triggered because there is the production of an alloy in the making of Value Added Product Aluminium. Similarly, for i/c spot sales, a market price may be close to the actual transaction price, but for transactions under longer term contracts, prices will typically have been determined at the time of entering into the contract which may be different from the spot price on the date of the physical transaction. It will be important that a simple, clear approach to the determination of MV can be endorsed in the Model Rules and commentary so that MNEs have certainty.
27 (e)	Determination of the "Delineation Point"	"Where there is convergence with one or more tests under the Delineation Point, the application of the test is established by the test that appears first in the order of the sub-paragraphs above"	Please clarify what "Convergence" means in this context.
29	Definition of "Independent Party"	"Independent party" means an Entity in which the Group holds less than a 25% ownership interest.	Query whether "Independent party" should be defined as an Entity in which the group does not have a controlling interest, consistent with similar definitions in the Tax Base paper.
30	Definition of "Intra-Group"	"Intra-Group" means between the Group and an Entity that is not an Independent Party.	Suggest this definition be "Intra-Group" means between Group Entities that are not an Independent Party.
32	Step 3	"Groups that meet the general scope provisions in Step 1, and also have above EUR 20 billion of in-scope third party revenues after the application of Step 2, will	Add wording to tie in the possibility that groups may skip Step 2 where there are intra-group revenues. "Groups that meet the general scope provisions in Step 1, and also have above EUR 20 billion of in-scope third party revenues after the application of Step 2, ***or which choose to skip Step 2 as provided for***

Para	Topic	Issue	Recommendation
		need to identify the profits derived from Extractive Activities and exclude these from Amount A."	***in [article reference],*** will need to identify the profits derived from Extractive Activities and exclude these from Amount A.
33	Step 3 Determination of profit margin where delineation involves an intragroup transaction (ie 27 (b)	It is important that the rules recognise the complexities and anomalies that could arise as a consequence of the requirement to determine the profit margin under Step 3 by reference to in-scope revenues, in circumstances where the delineation point involves an intra-group transfer (ie application of 27 (b)). Where this is <u>not</u> achieved, residual profits from Extractives Activities will be allocated to market jurisdictions under Amount A.	We agree it is important there is an accurate identification of profits and profitability of non-Extractives Activities to ensure the threshold in Step 3 is not breached as a consequence of inflated profit margins produced by the mathematical formulas, and that any resulting reallocation is not likewise inappropriately inflated. Where this is <u>not</u> achieved, residual profits from Extractives Activities will be allocated to market jurisdictions under Amount A. As noted in para 33, this will be of vital importance to Groups which perform activities across the extractives value chain. In determining the relevant profit margin under Step 3, the result for a Group which undertakes an integrated value chain should not differ in principle from the outcomes that would be relevant to Groups that are not engaged in Extractives Activities but are engaged in the same processing activities. For example, the profit margin determined under Step 3 where there is a delineation point between the extraction of bauxite and the refining of that bauxite into alumina because of the application of 27(b), the profit margin for the alumina segment/entity as determined under Step 3 should align with the profit margin outcome that would arise for a standalone business which undertakes the refining of alumina, but which is not also involved in Extractives Activities. Where the determination of in-scope revenue under Step 3 takes total revenue and then subtracts the excluded revenue, the profit margin will be artificially inflated compared with a standalone refining business. Refer to example in Appendix 1. The commentary in para 35 appears to recognise this point by indicating that in the determination of outcomes under Step 3 for a "downstream" segment which predominantly derives revenue from

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			manufacturing products purchased from the upstream segment must not remove the extractives revenue from the downstream segment. As noted above, arm's length intra-group prices used by an MNE should be respected in the determination of the profit margin – for example in an integrated supply chain where the in-scope business has acquired the extracted material for further processing. We believe the determination of profit margins for in-scope activities under the Extractives Exclusion should be carefully reviewed as part of the Early Certainty Process ("ECP"). As mentioned earlier, the ECP can follow the overriding principle that the allocation methodology used should not deliver a different result for an entity undertaking similar in-scope activities but which does not have Extractive Activities.
33	Step 3 Determination of profit margin where delineation occurs because of an Internationally Recognised Reference Price (27(c)) or because of the "backstop" in 25 (c) – delineation point 27(d)	Similar issues arise as for the intra-group scenario outlined above. Where there is a mixed segment and where either 27 (c) or (d) apply, the in-scope revenue is calculated as Total segment revenue minus excluded revenue per the delineation point. Where either 27 (c) or (d) apply, the excluded revenue is effectively the market value of the extracted material.	As above, it is important there is an accurate identification of profits and profitability of non-Extractives Activities to ensure the threshold in Step 3 is not breached as a consequence of inflated profit margins produced by the mathematical formulas, and that any resulting reallocation is not likewise inappropriately inflated. Where this is not achieved, residual profits from Extractives Activities will be allocated to market jurisdictions under Amount A. A delineation point based on either 27 (c) or (d) will be relevant to Groups which perform activities across the extractives value chain. In other words their integrated supply chain extends beyond those delineation points, resulting in the need to split revenues and profits between the excluded and in-scope activities. For example, the group has extractive activities but a delineation point is triggered by reference to either the test in 27 (c) where the Index applies or where the activities no longer represent "Qualifying Processing" and the backstop in 25 (c) applies, resulting in the application of 27 (d). In both of these instances the underlying material undergoes further

Para	Topic	Issue	Recommendation
			processing beyond the delineation point and is ultimately sold to a third party. As above, in determining the relevant profit margin under Step 3, the result for a Group which undertakes an integrated value chain should not differ in principle from the outcomes that would be relevant to Groups that are not engaged in Extractives Activities but are engaged in the same processing activities. Similar to the scenario above involving intra-group transfers, where the determination of in-scope revenue under Step 3 takes total revenue and then subtracts the excluded revenue, the profit margin will be artificially inflated compared with a standalone refining business. Refer to example in Appendix 2. It is not clear that the application of Step 3 in circumstances where the delineation point is by reference to either 27 (c) or (d) does not result in inflated profit margins due to the mathematical formulas which apply the "deemed revenue" of essentially the market value of the product at the delineation point, notwithstanding the fact that the same product is ultimately sold and the third party revenues are reflected in the segment revenues. The resulting reallocation would likewise inappropriately inflated. Specifically, under the DOS approach the relevant formula is: [in-scope revenue] = [segment revenue] *minus* [excluded revenue "<u>reflected in the segment</u>" as defined by the Delineation Point]. Under the Entity approach the relevant formula is: [in-scope revenue] = [entity revenue] *minus* [excluded revenue as defined by the Delineation Point].

Para	Topic	Issue	Recommendation
			Under both 27 (c) and (d) the "excluded revenue….as defined by the Delineation Point" is essentially market value (index based under 27 (c) and MV under 27 (d). Application in this manner will result in an inflated profit margin as noted above – see Appendix 2. It is not clear what "reflected in the segment" means, and whether this is intended to rectify the anomaly. We also note that the same outcome should result in respect of the in-scope activity whether that activity sits in the same segment as the Extractive Activities or a different segment – this requires additional consideration in the context of the wording "reflected in the segment". Likewise, the same outcome should result in respect of the in-scope activity whether that activity sits in the same entity as the Extractives Activities or a different entity. **We are happy to provide more detailed analysis on the differences that may flow here.** These outcomes are at odds with the commentary in para 35 which appears to recognise this point by indicating that in the determination of outcomes under Step 3 for a "downstream" segment which predominantly derives revenue from manufacturing products purchased from the upstream segment must not remove the extractives revenue from the downstream segment. We welcome the clarification in paragraphs 37 and 40 that for the purposes of calculating revenues (and profits) for the purposes of step 3, that intra group revenues should be taken into account, and that the results should be bifurcated in line with accounting segmentation principles (which would recognise that the sum of segment revenues will exceed group revenues due to intra-group transactions, but that profits are appropriate split across the segments). We would welcome clarification in earlier paragraphs of this interpretation.

Para	Topic	Issue	Recommendation
34	Identification of in-scope profits	Step 3 requires groups to look at either reporting segments or legal entities in order to determine the relevant profits that are excluded vs in-scope.	Some groups may be already required to separately report oil producing activities (e.g. oil and gas companies listed on NYSE have an obligation regulated by the SEC and the FASB to disclose revenue and profit before tax information related to their oil and gas producing activities in their 20-F.) We would welcome a simplification that would allow groups to electively use this as an alternative approach by leveraging other such publicly reported data to determine their relevant excluded vs in-scope revenues and profits, where this data aligns with the policy objectives.
34	Identification of in-scope profits Use of Disclosed Operating Segment approach vs Entity-level approach.	Para 34 states: "First, the Group must identify its in-scope profits, using either the Disclosed Operating Segment (DOS) approach or, where this approach is not applicable (either because the Group does not have Disclosed Operating Segments or where it cannot reliably attribute revenue and costs as described below), the Entity-level approach."	To assist in managing compliance and complexity, groups should have maximum flexibility on whether to apply the DOS approach or the Entity approach. This enables them to choose the approach which best suits their processes/systems etc. Para 34 as currently drafted suggests that the DOS approach is primary, with the Entity approach as a fall back where the group does not have DOS or where it cannot reliably attribute revenue/costs. I.e., the framing suggests that a group is not eligible to apply the Entity approach unless these things can be proven/demonstrated. This risks disputes over whether the group can or cannot reliably attribute revenue/costs in circumstances where the underlying principle is entirely subjective in nature.
34	Disclosed Operating Segment	Disclosed operating segment is not defined	Suggest to define such term and refer to accounting standard definition when doing so.
36	Use of Disclosed Operating Segment approach	Para 36 is framed on the basis that the two dot points are "conditions"	Question whether these two dot points are truly "conditions" that dictate whether a group can "rely" on the DOS approach or whether those two elements are simply requirements in the application of the DOS approach. This is relevant in respect of the simplification suggestion made in respect of para 40.
37, 39, 45	Application of the "predominance test".	Paragraphs 37, 39 and 45 seek to apply predominance tests to segments/entities in order to identify which segments/entities are truly mixed and must have their profits	We strongly welcome the approach of using a percentage-based threshold of extractive revenues in order to alleviate the administrative burden of splitting segments/entities that involve predominantly extractive activities and revenues. We believe that a fixed monetary threshold (suggested to be

Para	Topic	Issue	Recommendation
		bifurcated between in-scope and excluded, compared to those which are predominantly extractive with only incidental revenues (or deemed revenues) related to activities not qualifying as extractive activities.	EUR 1 billion) is unnecessary where the percentage test is set appropriately high, and note that over time it could cause significant challenges as inflation reduces the relative value of this monetary threshold. We therefore recommend that the fixed monetary threshold is removed, and the percentage-based threshold be set at a level that can give delegates comfort that a sufficient predominance of extractive revenues is required in order for the exclusion to apply to an entity/segment.
37	Application of the "predominance test".	Whilst para 37 recognises that in applying the "predominance test" you take into account third party, intra-group and deemed revenue, there is no articulation of how to determine "intra-group" revenue for this purpose.	Clarification is required on how to determine "intra-group" revenue. We believe that the arm's length intra-group price should be respected. To do otherwise risks further complexity and disputes.
38	Predominance test for determining in-scope segments	Para 38 states "in-scope revenue is calculated as the segment revenue minus the excluded revenue reflected in the segment as defined by the Delineation Point"	We assume this means you take the total revenue of the segment and ONLY reduce this amount for excluded revenue which is defined by the Delineation Point. This means that total segment revenue would be reduced by [index * quantity] in respect of the application of 27(c) and/or [MV * quantity] where the backstop has applied via the operation of 25 (c). It is not clear what "reflected in the segment" means – clarification is required.
38	Determining in-scope segments	Simplification utilising the profit margin of the segment. The para indicates that the profit margin of the segment could be used as the starting point for the purposes of determining the profit margin of the in-scope activities. The para goes on to say that adjustments are "necessary" to allocate unallocated costs.	We agree that this is a useful simplification. The simplification benefit would be enhanced by making the allocation of unallocated costs optional rather than "necessary" where that allocation is TO the relevant segment. For example, an in-scope segment may have an overall profit margin below the threshold of 10%. The allocation of unallocated costs TO that segment will only further reduce the profit margin for that segment. In this scenario the additional compliance of making the allocation is not determinative to the outcome. Further, the application of

Para	Topic	Issue	Recommendation
			segmental accounting rules may already ensure that income and expenses are appropriately matched within segments.
38	Treatment of unallocated costs	It is envisaged, as part of the segmentation rules, that this [allocation of costs] will be performed using objective criteria.	Further clarification is required on these criteria.
39	Mixed segments	Para 39 states in-scope revenue "is calculated as the segment revenue minus the excluded revenue reflected in the segment as defined by the Delineation Point"	We assume this means you take the total revenue of the segment and ONLY reduce this amount for excluded revenue which is defined by the Delineation Point. This means that total segment revenue would be reduced by [index * quantity] in respect of the application of 27(c) and/or [MV * quantity] where the backstop has applied via the operation of 25 (c). It is not clear what "reflected in the segment" means – clarification is required.
40	Allocation of costs to segments and between the in-scope and excluded elements of the segment	Two adjustments are required: 1. Allocation of unallocated costs to the segment; 2. Inter-segment allocation of costs;	We accept that the second adjustment is required to get a true reflection of the profit margin of both parts of the segment, although the application of segmental accounting rules may already ensure that income and expenses are appropriately matched within and between segments. In respect of the first adjustment, a simplification benefit would be to make the allocation of unallocated costs optional rather than "necessary" where that allocation is TO the relevant segment. For example, an in-scope part of the segment may have an overall profit margin below the threshold of 10%. The allocation of unallocated costs TO that segment will only further reduce the profit margin for that segment. In this scenario the additional compliance of making the allocation is not determinative to the outcome.
41	Combination of in-scope segments	Para 41 requires multiple in-scope segments to be combined	We are strongly supportive of the requirement to combine the in-scope portions of the segments in considering the profitability margin as the simplest approach.

Para	Topic	Issue	Recommendation
42	Calculation of the profit margin	"The denominator is the in-scope Revenue amount reflected in the in-scope segments".	It is not clear what "reflected in the segment" means – clarification is required.
43	Complexity of DOS approach	Para highlights the complexity of the approach but also the benefits of the approach	As noted above, to assist in managing compliance and complexity, groups should have maximum flexibility on whether to apply the DOS approach or the Entity approach. This enables them to choose the approach which best suits their processes/systems etc.
44	Application of the Entity-level approach	Para is framed in a way which suggests that the Entity-level approach is only required if the conditions in the DOS approach cannot be met.	See comments above. I.e., the framing suggests that a group is not eligible to apply the Entity approach unless these things can be proven/demonstrated. This risks disputes over whether the group can or cannot reliably attribute revenue/costs in circumstances where the underlying principle is entirely subjective in nature.
44-48	Identifying Profits using the Entity-level approach	The term "Entity" is not defined in the document.	It's necessary to define the term "Entity" to understand how flow-through entities (e.g., partnerships) are treated for the Extractives Exclusion.
47	Aggregation of in-scope entities	Group to combine in-scope entities into a consolidated bespoke segment for Amount A purposes.	We are strongly supportive of the requirement to combine the in-scope portions of the entities in considering the profitability margin as the simplest approach.
51	Carry forward losses	The para notes that a group would carry forward losses but acknowledges the challenges of doing this.	This is likely to be easier where a group applies the Entity-level approach thus another reason why the use of the Entity-level approach should be optional and not be limited to ONLY where the requirements of the DOS approach are not met

Appendix 1: Application of Step 3 in an integrated supply chain – 27 (b)

- A group undertakes Extractive Activities in Country A where the extracted material is sold to a related entity in Country B for additional processing before sale to third parties;
- The delineation point occurs under 27 (b) when the material is transferred to Country B for processing;
- The accounts for the group and each individual entity are reflected below:
    - The group has total revenue of $110, representing the third-party sales. It also has total costs of $80, representing the total of extraction costs and processing costs, resulting in a group profit of $30 and a profit margin of 27% (30/110);
    - Entity A which undertakes the Extractive Activities has related party revenue of $100, resulting from the sale of the material to Entity B. It also has extraction costs of $75, resulting in a standalone profit of $25 and a profit margin of 25% (25/100);
    - Entity B which undertakes the in-scope activities has third party revenue of $110. It also has related party purchase costs of $100 and processing costs of $5, resulting in a standalone profit of $5 and a standalone profit margin of 5% (5/110);
- A profit margin calculated for the in-scope activity under Step 3 by taking the Entity B revenue of $110 minus the $100 excluded revenue relevant to the Extractive Activity **would result in a profit margin for the purposes of Step 3 of 50%** - calculated as $5 profit/ [$110-$100=$10] revenue. **This is significantly in excess of the actual standalone margin of Entity B of 5%.**
- The paper indicates for the purposes of Step 3 under both the DOS and Entity approaches the in-scope revenue is calculated as [segment/entity revenue] *minus* ["excluded revenue ….as defined by the Delineation Point"]. On the basis that there is no "excluded revenue….as defined by the Delineation Point" where 27(b) applies, we believe the outcome consistent with the policy expression in the paper will result. Specifically, the in-scope revenue will be revenue of $110, with no subtraction of the excluded revenue. **This results in a profit margin consistent with a standalone in-scope business of 5% ($5/$110).** This is aligned with the policy statement in para 35 which indicates that in the determination of outcomes under Step 3 for a "downstream" segment which predominantly derives revenue from manufacturing products purchased from the upstream segment must not remove the extractives revenue from the downstream segment.

	Country A Entity A Extraction		Delineation point	Country B Entity B Offshore Processing		Group	
Revenues							
Related Party Revenue	100			0		0	
Third Party Revenue	0			110		110	
		100			110		110
Costs							
Related party purchase	0			-100		0	
Extraction costs	-75			0		-75	
Processing costs	0			-5		-5	
		-75			-105		-80
Profit		**25**			**5**		**30**
Margin recognised in accounts		**25%**			**5%**		**27%**

Appendix 2 – Application of Step 3 in an integrated supply chain – 27 (d)

- Entity A undertakes Extractive Activities. Entity B, located in the same State, undertakes additional processing before sale to third parties. The additional processing does not satisfy the definition of "Qualifying Processing" and therefore the backstop in 25(c) applies;
- The group has total revenue of $110, representing the third-party sales. It also has total costs of $80, representing the total of extraction costs and processing costs, resulting in a group profit of $30 and a profit margin of 27% (30/110);
- Entity A which undertakes the Extractive Activities has domestic related party revenue of $100 (MV for the purposes of this example) from its sale to Entity B. It also has extraction costs of $75, a standalone profit of $25 and a profit margin of 25% (25/100);
- Entity B which undertakes the in-scope activities has third party revenue of $110. It also has related party purchase costs of $100 and processing costs of $5, resulting in a standalone profit of $5 and a standalone profit margin of 5% (5/110);
- A profit margin calculated for the in-scope activity under Step 3 by taking the Entity B revenue of $110 minus the $100 excluded revenue **would result in a profit margin for the purposes of Step 3 of 50%** ($5 profit/ [$110-$100=$10] revenue). **This is significantly in excess of the actual standalone margin of Entity B of 5%.**
- The paper indicates under both the DOS and Entity approaches in-scope revenue is calculated as [segment/entity revenue] *minus* ["excluded revenue … .as defined by the Delineation Point"]. The delineation point under 27(d) provides "the deemed Revenue amount for the purposes of identifying the excluded revenue and for applying the profitability test" is calculated as Revenue = [Market value of the Extractive Product] * [Quantity of Extractive Product];
- This will result in in-scope revenue of $10 ($110-$100) and will **result in a profit margin of 50% ($5/$10) – this is inconsistent with a standalone in-scope business;**
- It is not clear what "reflected in the segment" means in the application of Step 3 although we note that the same outcome should result in respect of the in-scope activity whether that activity sits in the same segment as the Extractive Activities or a different segment. Likewise, the same outcome should result in respect of the in-scope activity whether that activity sits in the same entity as the Extractives Activities or a different entity.

	Country A						
	Entity A		Delineation point 27(d)	Entity B			
	Extraction			**non-Qualifying Processing**		**Group**	
Revenues							
Related Party Revenue	100			0		0	
Third Party Revenue	0			110		110	
		100			110		110
Costs							
Related party purchase	0			-100		0	
Extraction costs	-75			0		-75	
Processing costs	0			-5		-5	
		-75			-105		-80
Profit		**25**			**5**		**30**
Margin recognised in accounts		**25%**			**5%**		**27%**