BUSINESSatOECD

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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 "Progress Report on Amount A of Pillar One"

Dear Secretariat Team,

Thank you for the opportunity to comment on the Progress Report on Amount A of Pillar One ("Progress Report"). Before providing more specific explanatory commentary (Section 1) and detailed feedback (Sections 2-7) below, there are several observations we wish to highlight up front in this introduction.

As we have articulated to the Task Force on Digital Economy ("TFDE") before, we believe that practicality, administrability, and stability are core principles in the design of Pillar One that will best serve to ensure its successful implementation and sustainability over time. To that end, we are pleased to have the opportunity to offer 1) suggestions regarding the practical administration of the proposed rules, 2) alternatives to make the rules less complex while achieving the intended policy goals, and 3) suggestions on how to ensure Pillar One achieves its intended goal of stabilizing the international tax system while re-allocating a portion of excess profits from source to market jurisdictions.

We highlight five important observations below:

1. Withholding taxes ("WHT"): We want to emphasize the importance of including WHT in the overall design of Amount A. Specifically, we strongly believe that WHT should be taken into consideration when applying the marketing and distribution safe harbor ("MDSH") to avoid over-allocating residual profits to market countries (and in turn, under-allocating profits to other countries where the balance of the MNE's activities take place). We further believe that WHT needs to be considered in the elimination of double taxation, since WHT affect the amount of taxes actually paid by entities in the relieving jurisdiction. The treatment of WHT is a key threshold issue that needs to be resolved before the business community can fully comment on the overall design of Amount A. Similarly, as digital service taxes ("DSTs") and other relevant measures are rolled back, similar measures that are not in the scope of the rollback should be treated in the same way as WHT (i.e., taken into consideration in calculating Amount A).
2. MDSH: We understand the policy goal of the MDSH is to identify situations in which excess returns are already sourced and taxed in the market, with a resulting reduction in Amount A to be allocated to the market. The return on local depreciation and payroll ("RODP"), which can vary significantly by MNE and has a minimum implied routine return of 40%, can

cause illogical distortions (e.g., where results diverge based solely on the degree to which an MNE outsources various aspects of its supply chain). It also does not fully account for decentralized domestic businesses, where the current mechanism can result in the re-allocation of profits from one market jurisdiction to another unrelated market jurisdiction. Finally, we strongly believe that there should be no Y "offset percentage", which is consistent with the fact that Amount A is only intended to reallocate a portion of a MNE's excess returns. Any Y percentage below 100% will commonly result in more than 25% of excess returns sourced to the market country under Amount A and existing transfer pricing, which can be considered as being inconsistent with intent of the October 2021 statement.

3. Elimination of double taxation: We continue to be concerned about the digression from traditional forms of nexus, as evidenced by a complete absence of any reference to market connection in the elimination mechanism. However, we understand that the TFDE members and some MNEs view this as a matter of administrative convenience. That said, the current formulaic approach, when applied together with the MDSH, can cause distortive results that are misaligned with the intended goal of Pillar One (we have modeled out several scenarios in Appendix 2). Also, given potential differences between a country's elimination tax base and actual tax base, we recommend including a backstop mechanism to ensure that all Amount A is relieved from double taxation, as discussed further below. Finally, we strongly believe that elimination of double taxation should be carried out via an exemption method, as applying existing foreign tax credit regimes to Amount A will result in double taxation.
4. Comments on existing building blocks: We may repeat observations provided in previous public consultations of various building blocks. We recognize that the TFDE has considered and in some instances made accommodations to some of our comments. Nevertheless, we believe that other points previously raised bear being repeated here, especially where we perceive that the Progress Report provides guidance that is at odds with the October 2021 statement. Examples include revenue sourcing for B2B MNEs, revised scoping rules which may bring more MNEs that are not consistently "large and highly profitable" into Amount A, considerations for decentralized business models, consideration for loss carryforwards and profit shortfalls, and treatment of less than 100% owned entities.
5. Amount B: We recognize that the Progress Report excludes but makes reference to continued work on Administration, unilateral measures, Amount B, and the treatment of WHT. We welcome recognition of all these elements, which we see as critical to the stabilization of the international tax system. We have commented on unilateral measures and WHT above, and we will reserve comment on Administration to the future. For Amount B, we see that the extension of time to complete the model rules for Amount A provides the opportunity to realign work on Amount B with Amount A. We look forward to engaging with the TFDE in the future in this area, and we encourage the TFDE to also consider ways to further integrate the two, including for instance possible consideration of incorporating Amount B into the MDSH.

Finally, while we have been afforded more time to provide comments, we nevertheless believe that additional work and engagement between the business community and the TFDE is warranted beyond this public consultation period, with a particular focus on the results of applying these rules to in-scope MNEs – both initially and after the scope broadens in seven years.

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 provide 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)

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Table of Contents

1. Explanatory commentary

1.1. Updates to existing building blocks

Before commenting on key new features presented for the first time in the Progress Report, we believe it is appropriate to reiterate input from the business community on several carryover provisions from previous public consultations:

1.1.1. Revenue Sourcing & Nexus

We generally recognize the positive steps undertaken in response to the previous public consultation on this building block, including accommodations to alleviate some of the very detailed requirements previously proposed, as well as adding a transition period. These are improvements in the application of the rules, and we have provided additional suggestions herein to further improve certainty for both companies and governments. Of particular mention, we applaud the introduction of a transition period, but we believe that it should be extended to ensure that companies are provided sufficient time to complete the initial advance certainty process and adapt for any changes arising from that review, including building a system that can reliably obtain data needed. Also, given that revenue sourcing is foundational to the viability of Amount A, there will be additional pressure on the need for advanced early certainty on revenue sourcing and other methodologies in advance of the year in question.

We must otherwise continue to emphasize the novelty, scope and implications of the overall policy, which directs companies to not only source revenue based on the country of their customer, but to somehow identify the location of an end consumer in most cases. This is a particularly difficult mandate for B2B MNEs who were pulled into scope of Amount A in the Spring of 2021. It is worth reiterating that Amount A will compel such companies to source revenues, and therefore profits, to markets and countries that may bear little to no resemblance to the location of their business customer. We recognize that this is by design but continue to question whether the implications of this policy decision are fully understood. For instance, some enterprise businesses in particular may be compelled to use allocation keys as the only workable solution even as it may provide distortionary results.

1.1.2. Scoping

The proposed guidance concerning the exclusions for qualifying Extractives and Regulated Financial Services reflect improvements from the initial public consultation, although we provide supplemental feedback herein concerning ways to further clarify and improve the delineation between in-scope and out-of-scope revenues and profits of companies within the scope of the Extractives and Regulated Financial Services exclusions.

We otherwise see the Scope criteria (including the revenue and profit tests) as taking a step back from the initial public consultation, both in terms of their bias to pull into scope companies whose revenues and profits may fluctuate above and below the scoping criteria from year-to-year, as well as in the introduction of additional complexity in the criteria. The Progress Report states that the scope rules are “designed to ensure that Amount A only applies to large and highly profitable Groups.” Habitually including MNEs on the cusp of the thresholds seem contrary to this objective. At the least, we suggest the TFDE consider returning to the criteria set out in the initial public consultation.

We also continue to be concerned that the segment criteria (Title 1, paragraph 6) remain one-sided: pulling into scope certain Disclosed Segments, but not offering any additional exclusions, in particular where companies operate in whole or in part with decentralized business models. We see the failure to adequately address these business models in the Scope criteria as creating anomalous results in the measurement and allocation of Amount A and in the Elimination of Double Taxation, such as unintentionally reallocating profits from one independent market country to another. We continue to believe that addressing treatment of decentralized businesses, while necessarily complicated, warrants additional consideration. For example, scope criteria could be further modified such that jurisdictions would only fall in scope of Amount A if cross-border related party transactions, including royalties, represent more than [20]% of a jurisdiction's aggregate net turnover together with other criteria. More details are presented in the attachments.

Finally, we believe it is imperative that segmentation rules do not create competitive distortions in the marketplace.

1.1.3. Tax Base

We recognize the Progress Report reflects certain changes from the initial public consultation, including those regarding the treatment of gains and losses from the dispositions of businesses. The changes provide for more consistent treatment between the buyer and seller in such transactions, but they do not necessarily produce satisfactory outcomes in terms of neutrality in all cases.

But our primary areas of comment and concern lie with the continued inadequacies in dealing with loss carryforwards and profit shortfalls and in still including in Amount A the share of revenues and profits of majority-controlled businesses that MNEs do not own. On loss carryforwards and profit shortfalls, the Progress Report shows little improvement and indeed some level of retreat from the initial public consultation: there is limited consideration of loss carryforwards and not any consideration of profit shortfalls in the measurement of the Amount A tax base. As we have previously noted, failures to fully account for both will inevitably lead to an uneconomic over-allocation of residual profits to market countries and a corresponding under-allocation to countries where the MNE's entrepreneurial investments and activities take place. This may certainly apply to companies coming out of early-stage investment mode, but it can also apply to companies at later stages of the life cycle that are adapting to changing economic conditions. In terms of majority-controlled businesses, it seems illogical to include in the tax base 100% of the profits when a portion of those profits economically belong to unrelated enterprises or investors. Further, it seems illogical to require wholly owned constituent entities in the MNE group to relieve the tax on those amounts based on their economic returns unrelated to the majority-controlled business. A proportionate approach is the only logical answer, and revenues should be adjusted if necessary to align with the percentage profits to be included (as required in the Progress Report for jointly-controlled Joint Ventures). Please see further discussion of this point in Section 1.3.1 below.

1.2. Comments to new building blocks

We now turn our attention to the two new features included in the Progress Report: rules governing the application of the so-called MDSH and the Elimination of Double Taxation.

1.2.1. Marketing and Distribution Safe Harbor

We understand the policy goal of the MDSH is to identify those situations in which excess returns are already sourced and taxed in the market, with a resulting reduction in Amount A to be allocated to the market. To this end, we first reiterate our view that the analysis should take into consideration any WHT imposed by market jurisdictions on residual profits that are realized in another country. Therefore, while not yet provided in the MDSH, the business community has an expectation that WHT imposed on residual profits are accounted for in the MDSH mechanism in its final version. We also think this will be necessary to ensure that changes in domestic legislation in the future (whether in replacement of a DST or otherwise) do not further increase source-based taxation in addition to the allocation of Amount A to market countries.

The MDSH otherwise provides for a variable return on local depreciation and payroll ("RODP") in the identification of excess returns, including an unexplained minimum implied routine return of 40% of local costs (described as the Elimination Threshold RODP). We question the merits of this shift in focus from return on sales (for purposes of measurement of Amount A) to a return on some, but not all local costs in the measurement of the MDSH, and in particular where the RODP varies from company to company and where an overall floor is mandated without explanation. We expect to see significant differences in the elimination threshold RODP across companies. It is difficult to rationalize the policy behind such variations between companies – or the 40% minimum threshold – as an appropriate means by which to identify excess returns in market countries.

Further, we observe that using this RODP approach will result in variations in the share of systems profits sourced in market countries based on the relative size of the market. For example, some MNEs are seeing higher levels of systems profits sourced to larger market countries, and lower levels for smaller countries.

Finally, we also observe that the current mechanism could lead to divergent results based solely on the degree to which the MNE outsources various aspects of its supply chain. While this discussion goes well beyond this written submission, we offer three examples herein:

1. An MNE may choose to operate through a split supply chain business model. This can be through an arrangement where IP is licensed to a third party in the market country. In this instance, some portions of excess returns are already sourced and taxed in the local market and under the current draft provisions are not taken into consideration in the application of the MDSH. In contrast, the exact same excess returns in the local market would be considered for purposes of the MDSH if the local business was a wholly owned subsidiary. This example highlights stark disparate results in the measurement of Amount A for economically identical undertakings in the market country.
2. An MNE chooses to outsource some or all of its manufacturing to third parties, while retaining sales and distribution functions within the market countries. The decision to outsource reduces the level of payroll and depreciation undertaken directly by the MNE, resulting in a higher MDSH threshold and higher Amount A assigned to the market country.
3. An MNE may choose to build cloud computing capacity to serve users in market jurisdictions or rely on third parties to host their applications. The decision to build or buy here would have a significant impact on the MDSH calculation, unless the amount paid to the third-party hosting companies would be considered depreciation in the calculation under Schedule J.

In all cases, the Amount A allocation to the market country varies notwithstanding identical functions undertaken and levels of profits sourced and taxed in the market before consideration of Amount A. These results are a byproduct of the policy decision to measure MDSH based on the "Elimination Threshold RODP." We struggle to understand the policy justification for these divergent outcomes under economically identical fact patterns in the market country. The TFDE may wish to consider whether replacing the RODP with Amount B in the calculation of MDSH would alleviate these concerns.

In the absence of an exclusion for certain domestic oriented-business activities in the Scoping criteria (discussed above), we believe that the MDSH should otherwise include features that would acknowledge these types of business models. We don't believe that the current design features account for this, and this will lead to reallocations of domestic profits from one market country to another, particularly in instances where a MNE generates differing profit margins from country to country, or region to region. These fluctuations are not the result of profit shifting. Indeed, in many cases, most if not substantially all of the profits derived from that particular market are already sourced and taxed in the market country. This is an example of the unnecessary overreach of the application of Amount A, which should be reserved for particular situations where less than 25% of profits from a given market are sourced and taxed inside that country. Finally, we believe the absence of consideration for such business models will only grow in relevance if and when Amount A is expanded to a broader set of companies, as we believe those expanded scope companies are more, not less, likely to exhibit these characteristics. Accordingly, we make recommendations in our detailed comments to establish additional criteria in the MDSH to take such circumstances into consideration.

1.2.2. The Role of the Y Offset Percentage in the MDSH

The proposal includes a placeholder Y% to account for the portion of excess profits identified in the market jurisdiction that should reduce Amount A for that market under the MDSH. Consistent with the fact that Amount A is only intended to reallocate a portion (25%) of excess returns (defined as those in excess of 10% return on sales), we believe that there should be no Y percentage. Any Y percentage below 100% will commonly result in more than 25% of excess returns sourced to the market country under Amount A and existing transfer pricing, which can be considered as being inconsistent with intent of the October 2021 statement.

1.2.3. Adjustment to Elimination Profits for the MDSH

Where the MDSH reduces Amount A otherwise allocable to a particular country, the proposals provide that the country's Elimination Profits be reduced. Elimination Profits are those identified as the pool of profits to be used to eliminate double taxation (discussed below). Conceptually this provision makes sense, although as mentioned above we believe that a further adjustment is required to take into account WHT that have reduced the tax base of the eliminating jurisdiction. This WHT adjustment could be deducted from Amount A before the MDSH is applied.

The proposal further provides for a placeholder wherein the Elimination Profits may be reduced by an as yet unspecified multiple of the MDSH adjustment. While we need more information, this, too, could make sense as Amount A is again intended to address only a partial (25%) reallocation of excess profits. Accordingly, we could foresee merits in a 4x multiplier which would effectively remove all excess profits from a given market country from reallocation to another. While we see this as possibly having theoretical merit, we don't believe this adequately addresses all concerns raised about domestic-oriented business models, particularly those with varying levels of profitability across geographies. This area in particular warrants additional modeling to evaluate its impact more fully across differing business models.

1.2.4. Elimination of Double Taxation

We recognize the political dynamics of the methodology chosen by the TFDE in its proposed approach to eliminate double taxation for Amount A. As noted above, we believe that WHT needs to also be considered in the elimination of double taxation calculations.

We continue to be concerned about the digression from traditional forms of nexus in the complete absence of any considerations as to whether the operations of the MNE in the surrender country have any market connection with the countries receiving allocations of Amount A. This is a disturbing continuation of a trend we also see in the allocation of taxation rights under the Pillar Two undertaxed payment rules. We understand that TFDE members view this as a matter of administrative convenience. We also recognize and acknowledge that some companies would simply not be able to apply traditional norms of nexus in identifying relieving jurisdictions due to the policy decision to measure Amount A based on global pre-tax book income, without regard to which line(s) of business contributed to Amount A.

Given the formulaic approach taken in this relieving mechanism, including the possible multiplier noted above, we recommend the inclusion of a backstop mechanism to ensure that all Amount A is relieved from double taxation, either by adjusting the total level of Amount A allocations or by modifying the adjustments to elimination profits for the MDSH, discussed above. Additional mechanisms to ensure relief of double taxation will also be required in cases where relieving jurisdictions, as determined by the elimination rules, are not parties to the Multilateral Convention (“MLC”).

In addition, the method of elimination is still left to each country to decide, exemption or credit. If the method of elimination were to be left to the choice of each country, the foreign tax credit method has, in many countries, all traditional restrictions including the limit on maximum amount and carryforwards. If the system is designed based on these restrictions in each country, it is highly likely that double taxation cannot be completely eliminated. For this reason, we highly support an exemption rather than a credit mechanism. If a credit mechanism must be used, a mechanism where there are no maximum credit limit or carry-over period should be stipulated in the MLC. Finally, the risk of double taxation and administrative burdens would be lessened if a uniform system is adopted.

Beyond these policy points, the administration of the elimination of double taxation could be simplified by ensuring that the elimination profit and the tax base calculations are aligned. The TFDE should also consider safe harbor measures which would reduce the number of jurisdictions for which such complex calculations are required.

1.3. Other observations

1.3.1. Less than 100% owned entities

Another area that warrants additional analysis and consideration is in the treatment of businesses that are less than 100% owned by an MNE. Even if less than 100% owned, an entity will be consolidated on a line-by-line basis in the Group financial statements where it meets the relevant accounting test of being a controlled entity. We believe the Progress Report does not provide sufficient guidance which would address the diverging outcomes that would result from how MNEs incorporate less than 100% owned entities in their ownership structure.

We note that the Progress Report contemplates that there will be proportionate inclusion of income and revenues for a Joint Venture or Joint Operation where there is joint control, and we support this. We further note and support that in the case of investments which are equity accounted, where there is no joint control but significant influence, the Progress Report contemplates that this equity income should be excluded from the tax base. We believe that the concept outlined for jointly controlled joint ventures and joint operations should be extended to consolidated but less than 100% owned entities to address the issues that would arise on the effective elimination of double taxation and potentially also revenue sourcing. Specifically, where an entity is consolidated on a line-by-line basis but is less than 100% owned, then we suggest that the Revenues, Tax Base, and Elimination Profit should be proportionally adjusted for the % not owned. In the case of Revenues (for the purposes of Revenue Sourcing by jurisdiction), this would be done on a pro-rata basis unless a more precise approach is identified.

1.3.2. Transition period

Whilst we welcome the transition period of 3 years and an additional soft-landing period of 3 years for Revenue Sourcing, we believe that given the complexity and novelty of this new taxing right, the transition period should extend until the point that a taxpayer has concluded its early certainty process and have had time to modify its systems to obtain reliable data. This recognizes that implementation may be more challenging for some MNEs than others and the practical impact of the likely demands on tax authority resources. One idea is to set the transition period at seven years and revisit it in conjunction with scheduled discussions on expanding the scope of Amount A.

1.4. Concluding Observations

Ultimately, we believe that these draft model rules should be evaluated based on their results. If one accepts the premise that the international tax system has become destabilized because it insufficiently recognizes the different ways in which businesses today can access a market without necessarily having a significant local taxable presence, the question to be answered is whether Pillar One as now framed will provide that stability. Taking all elements into consideration, to what extent do these draft model rules accurately identify and partially reallocate excess returns earned from customers in a market country that are otherwise sourced and taxed in another? Conversely, to what extent do they inadvertently reallocate profits that are generated in one market country to another market country by virtue of the formulaic mechanics of the rules?

While the rules as designed may be effective in achieving the stated goals for some companies, we believe that a substantial majority of in-scope companies will in fact see varying degrees of unintended distortions. What are the circumstances in which the rules may be effective, and to what extent do these rules create unintended distortions for others? To begin the work to answer such questions, we provide in Section 7 (Appendix 2) a summary of key take-aways from the application of the draft models to seven in-scope MNEs. These are offered as a starting point to what we hope is a more comprehensive analysis and consideration of the implications of the applying these draft model rules to companies with varying business models and financial results across the world.

We recognize that some of these distortions will arise as a byproduct of political and policy decisions made in an attempt to simplify and streamline the rules to apply to all businesses. We also recognize the desire and need to reduce complexity, which we hope will in turn improve certainty. But we suggest that further work be undertaken to weigh these considerations more fully before the rules are set in stone. This reflects our desire to further reduce unintended distortions where possible while maintaining ease of administration and maximum tax certainty.

Our detailed comments are provided in the following sections.

2. General comments

Section	Topic	Issue	Recommendation
Background	Non-consensus	Again, it is concerning that the proposals are prepared by the Secretariat and do not represent a consensus view of the Inclusive Framework.	N/A.
Various	Legal grounds for Commentary	Some key concepts are left in the Commentary. However, the Commentary will not have the force of law.	The Commentary needs to be specifically incorporated by reference into the MLC so that its principles are part of the MLC and will carry the force of law. Otherwise, countries will be free to interpret various concepts as they see fit, resulting in a similar patchwork of rules that Pillar One is intended to avoid, and leading to many disputes.
General + Title 7 para 14	Definition of "Revenues"	The definition of "Revenues" is an adjusted number (adjusted for sub-para's a-d). The interchangeability throughout the document of "Revenues" (i.e., the adjusted number) and "revenues" (general usage, presumably drawn from its common usage meaning an item of revenue in the accounts) is confusing. Also, the definition of "Revenues" refers to excluding revenues relating to items excluded in Article 5(2)(b)-(c). Article 5(2)(b)-(c) refer to Excluded Dividends and Excluded Equity Gain or Loss. Given that revenue reported in Consolidated Financial Statements will not include dividends or equity gains or losses, it is not clear the intent of the reference to Article 5(2)(b)-(c). Revenues of a Group is subject to adjustment for revenues from a Joint Venture or Joint Operation to align with the Group's proportionate share of profit or loss from the Joint Venture or the Joint Operation.	See our original comments which suggest that the definition of Revenues should be specifically linked to "net sales/revenue/turnover" (i.e., the top line of the income statement). It is recommended that clarity is provided in the commentary with respect to the likely adjustment required in respect of Joint Ventures and Joint Operations. We assume the intention is to ensure the extent any revenues are included in Revenues under (a) to (c) is adjusted to align with the Group's share of revenue i.e., generally based on their ownership interest in a JV (including

Section	Topic	Issue	Recommendation
		The use of "adjust" may cause confusion as to whether the adjustment is an addition or subtraction. Practically, the adjustment should be an addition in respect of Joint Ventures (as they are not included in Revenues of a Group as reported in the Consolidated Financial Statements) and there is no adjustment required in respect of Joint Operations as these are already proportionately consolidated for the purposes of the Consolidated Financial Statements	where the investment is 100% consolidated but the ownership interest is lower). We further believe that if the Tax Base for consolidated entities where there is a non-controlling interest is adjusted per the placeholder at Title 4, Article 5, para 2(j), then it follows that Revenues should also be adjusted to reflect only the Group's ownership interest.
N/A	Administrative burden versus policy intent	Now that we can see the broader picture of how the rules will operate, we can fully grasp the level of complexity associated with the implementation. Even with a reasonable level of tax certainty, the rules would require MNE to develop IT systems to perform the calculations. Similarly, tax authorities will need to invest in resources to be able to review the calculations. The administrative burden which will be placed on both the MNE and the tax authorities must be consistent with the initial policy intent of Amount A (see comments on the MDSH and the elimination of double taxation).	We appreciate that some simplification measures were introduced (e.g., transition rules) based on our initial comments. We encourage the TFDE to again review the rules considering the initial policy intent and provide simplification rules whenever the application of Amount A allocation rules would not be consistent with the initial policy intent. We have suggested some further simplification measures in our comments below.

3. Comments on new building blocks

3.1. Marketing and distribution safe harbor

Section	Topic	Issue	Recommendation
Title 4, Article 6	MDSH	It is difficult to comment on MDSH as the rules are not fully set out, and many businesses do not have sufficient to perform modelling + interpret their results within 6 weeks.	We would like to have further opportunity to interact with the Secretariat/TFDE once the final rules have been released.
Title 4, Article 6	MDSH	The use of only Payroll and Depreciation as a basis for MDSH is backward looking. R&D/Innovation is not protected or promoted. The largest component that produces the consolidated profits is usually innovation (certainly in the bio-pharma sector, but not only) and jurisdictions that bear those costs are not rewarded since their residual profit will be up for elimination without any protection.	We suggest to incorporate R&D expense and costs associated with amortization of IP and acquired IP into the MDSH calculation.
Title 4, Article 6	MDSH deviating from arm's length principle	The MDSH is an essential part of Pillar 1 and a key to achieving the objective to bring stability to the international tax system. A country should not receive payment for taxing residual under Amount A, and separately tax the same residual profit through aggressive transfer pricing adjustments. To achieve this objective, it is reasonable to expect that the MDSH have some connection to transfer pricing principles, which are the basis for allocation of profits to marketing and distribution functions. Deviating the MDSH from transfer pricing result in distortive profit allocation. The approach in the progress report is not connected in any discernible way with transfer	We understand this is a heavily negotiated topic. Nonetheless we would like to state our reaction to the disconnection of the MDSH to the arm's length principle.

Section	Topic	Issue	Recommendation
		pricing or other relevant economic principles. As such, it is very difficult to see how the guardrails will achieve any real and meaningful stabilization of the audit environment.	
Title 4, Article 6	MDSH for decentralized groups	The MDSH does not address the issue of groups whose business model is essentially local, with entrepreneurs selling within a local market and producing locally. Indeed, as previously explained, for these MNE, applying a homogenous profitability test across the jurisdictions is bound to result in unintended consequences in light of the policy motivations for Amount A, with market jurisdictions subsidizing others without any sound economic rationale. Moreover, the administrative burden which will be placed on these MNE given the complexity of the rules will not be consistent with the policy intent of Amount A.	We therefore suggest having an entry test through a new point to Article 6 (i.e., preceding the MDSH) which could be drafted as follows: *"Where a Covered Group meets the cumulative conditions below, no allocation of profit shall apply to any of the jurisdictions in which the group operates [the percentages are only suggestions and could be subject to discussions]:* • *In each jurisdiction, more than [85%] of the external sales of the entities of the Covered Group take place with end consumers based in the jurisdiction, based on products and services which are predominantly manufactured and performed in the same jurisdiction; and* • *Intercompany cross-border transactions, including royalties, do not represent more than [20%] of the jurisdiction's revenues.* *The cross-border licensing of Intellectual Property Rights within the Covered Group shall not prevent the application of the present provisions, provided that the above conditions are met."* These criteria are objective and can be easily audited. The MNE could provide evidence that it meets the conditions as part of the Advance Certainty process.
Title 4, Article 6, para 4	De minimis absolute threshold test	The policy rationale is not clear. If the country in question is already receiving a portion of the consolidated profits in excess of its entitlement	There should not be any de minimis rule for access to MDSH.

Section	Topic	Issue	Recommendation
		under MDSH, there does not seem to be any reasons for MDSH not to apply based on a de minimis rule. This would simplify administration of P1 not to have to pay additional amount A to countries that are not theoretically entitled to it. For decentralized groups whose business model is such that the vast majority of the residual profit is already in the market countries, such a de minimis rule can result in an over-allocation of residual profits from one market jurisdiction to another.	
Title 4, Article 6, para 5	Y percentage	A Y% that is less than 100% can incentivize tax authorities to continue with aggressive audits, as not all excess profit gained will lead to equivalent reductions of Amount A.	The only reasonable amount for the offset percentage ("Y") is 100%. Therefore, it makes sense to eliminate this factor. As the MDSH has already deviated from its original intent of addressing excess profits arising from local marketing and distribution activities (i.e., it has become completely formulaic), we should no longer need to consider how much of the excess local profits are related to marketing and distribution activities. Any alternative will result in an over-allocation of residual profits to local markets. While there may be outlier scenarios that this factor was meant to address, it is not appropriate as a general rule. If there is a justification (which is not apparent) for this factor, it should only be applied in those appropriate unique circumstances. Therefore, the entire concept of Y% should be eliminated from the rules.
Title 4, Article 6, para 5	Alternative metrics for MDSH	As noted in Footnote 3, a pure RODP approach based on the contemplated thresholds could result in inappropriate outcomes in some circumstances.	One alternative metric can be based on a reasonable return on sales that is backed by public third-party data. While that may be a somewhat imprecise measure to apply to all companies, it can be more stabilizing than the current proposal, since it addresses the residual / routine profit allocation within the system that is

Section	Topic	Issue	Recommendation
		Marketing and distribution activities are typically not measured against depreciation or payroll because depreciation and payroll are often not the main driver of marketing and distribution profits. Therefore, using RODP decreases stability by driving irregular outcomes. Specifically, the RODP (including the 40% threshold) could either give significantly higher or lower returns than the otherwise arm's length remuneration for the given industry and/or business model. For example, as recognized in the Progress Report, setting the MDSH using an RODP may result in the safe harbor return being too low where a group performs routine distribution activities in a jurisdiction (which typically have low depreciation and payroll expenses).[1] In other cases, as the RODP is calculated form a 10% ROS, and a 10% ROS is generally considered higher than any routine returns under any objective transfer pricing norms (similarly, a 40% return on even limited costs is well above the level of a routine return), the RODP may provide a safe harbor return that is much higher than those earned by routine marketing and distribution functions. This leads to distortive outcomes where the MDSH is artificially high or low, resulting in higher or lower Amount A allocation than what is intended,	predominantly used currently by companies and auditors to allocate profit for these functions. For simplicity and consistency, we recommend that the Amount B fixed return could be used as a reasonable replacement for the proposed approach. For the avoidance of doubt, we recommend Amount B to replace the existing MDSH criteria of RODP; we are not recommending a fallback metric that can be added as another factor in the "higher of" rule. Similarly, the seemingly arbitrary and unprincipled "higher of the Elimination Threshold RODP or 40%" should be deleted. Otherwise, at a minimum, justification for the 40% threshold should be clearly articulated or otherwise the rule should be discarded.

[1] OECD (2022), *Progress Report on Amount A of Pillar one, Two-Pillar Solution to the Tax Challenges of the Digitisation of the Economy, OECD/G20 Base Erosion and Profit Shifting Project*, OECD, Paris, Fn 3.

Section	Topic	Issue	Recommendation
		especially if Amount B produces a different result for routine marketing and distribution. In the latter scenario questions also arise as to the application in practice of the MDSH and Amount B.	
Title 4, Article 6, para 5	Fallback metrics for MDSH	N/A. Suggesting a fallback metric for the MDSH.	The Amount A allocated to market jurisdictions should be capped such that any market jurisdiction earns no more than 25% of global system profit. Our rationales are listed below: • Gives market jurisdictions taxing rights over a more than sufficient amount of profit. One of the goals of Pillar 1 is to provide market jurisdictions with increased taxing rights over the residual profit of in-scope MNEs, which is allocated to market jurisdictions through Amount A. By setting the MDSH cap at no more than 25% of global system profit, market jurisdictions receive a more than sufficient amount of profit over which to exercise their rights. • Increases stability in the international tax system. An ultimate cap on Amount A does not prevent taxpayers (or tax authorities) from using traditional transfer pricing methodologies to allocate (or negotiate for) more profits than contemplated by the cap in a local jurisdiction. • Aligns with the formulaic approach to Amount A.
Title 4, Article 6, para 5	Definition of PEP	PEP is defined as "Portion of Elimination Profit" – Whilst "Elimination Profit" is defined, "Portion" or "Portion of Elimination of Profit" is not.	To clarify.
Title 4, Article 6, para 6	MDSH & Elimination	Where the deduction from Elimination Profit is greater than the actual MDSH adjustment, distortion will be created.	The policy objective of such a distortion should be clearly outlined. Business also needs additional information regarding the proposed multiplier. Preliminary modeling by some of our members suggests that the use of the multiplier is unlikely to reduce elimination profits to zero and may only change the tiering.
Schedule J	Eligible Assets and Eligible	Under the current definition of eligible assets and payroll costs, the RODP calculation and therefore the MDSH and Elimination Profit Tiers will be	One company has suggested including outsourced manufacturing and contract R&D in RODP payroll expenses.

Section	Topic	Issue	Recommendation
	Payroll calculation	different for economically equivalent businesses due to different choices made on outsourcing manufacturing. Note that leased assets are in scope because of the link back to consolidated financial statements. IFRS 16 required leased assets to be put on balance sheet.	
Schedule J, para 2.b	Definition of Depreciation	Paragraph 2.b states that "payments made to third parties for the use of, or the right to use, Eligible Assets". It is unclear whether this paragraph would apply to payments for the use of third-party servers.	Similar to the comment above, the rules should not treat economically equivalent businesses differently due to different choices on whether to outsource server capacity. The rules should clarify that Paragraph 2.b applies to payments for the use of third-party servers.
Schedule J	Eligible payroll costs	N/A/. Clarifications sought.	Please confirm payroll costs are based on book versus tax.
Schedule J, para 1	Jurisdictional Data	Determination of Jurisdictional return on costs for Elimination and MDSH	The calculation of jurisdictional profitability should be based on aggregated results of the legal entities in that jurisdiction (with an election for consolidation) to align with Pillar Two jurisdictional methodologies.
Schedule J, para 5	Definition Eligible assets	Eligible assets do not include property assets held for sale. A property asset would usually be considered as held for sale once a management decision is taken to divest that asset (or the business using the asset). There can be significant time lag between this initial management decision and any final sale. During this time, business profits within the scope of Amount A will continue to accrue and there doesn't seem to be a valid reason to exclude such property asset costs from eligible asset costs.	Where a property asset remains in use within the "ordinary course of business" (notwithstanding that it is treated as held for sale), it should continue to be included in eligible assets.

3.2. Elimination of double taxation

Section	Topic	Issue	Recommendation
Title 5	Elimination	The elimination mechanism is purely quantitative and being based on RODP, it is backward looking. R&D/Innovation is not protected or promoted. The largest component that produces the consolidated profits is usually innovation (certainly in the bio-pharma sector, but not only) and jurisdiction that bear those costs are not rewarded since their residual profit will be up for elimination without any protection.	We suggest to incorporate R&D expense and costs associated with amortization of IP and acquired IP into threshold return calculation.
Title 5, Article 8, para 1.b.	Elimination Specified Jurisdiction	The draft provides that in addition to jurisdictions representing 95% of elimination profits, jurisdictions with EUR 50 million are also added. Given the size of MNEs within scope of Amount A, adding each jurisdiction with EUR 50 million will increase the compliance burden and add unnecessary complexity.	We suggest to eliminate the EUR 50 million criteria.
Title 5, Article 10, para 2	Elimination Methodology	The draft provides that Elimination can be granted by way of exemption or credit in the jurisdiction. Additionally, footnote 5 notes that there will be "discussion of how elimination of double taxation could be provided in jurisdictions that have traditionally used methods other than the credit or exemption methods."	This should not be left to the decision of Countries, but it should be a mandated rule in MLC. The method, which must be looked at in connection with Administration concepts being developed and possible interactions with P2, must lead to an effective, immediate elimination of double taxation. The amounts should be exempted/reimbursed prior to/concurrently with any payment of additional tax that is paid to market jurisdictions. We strongly believe that the only way to ensure full elimination of double taxation is to respect that Pillar One reallocates taxing rights to Amount A and have the relieving jurisdictions exempt that

Section	Topic	Issue	Recommendation
			income from taxation. The entire Amount A proposal is centered on a transfer of tax base from residual profit owners to market jurisdictions – an exemption system does exactly that and does it much more cleanly and precisely than a credit approach. Credit relief systems inherently come with restrictions both in timing of use as well as availability based on sourcing of the income and taxation of the underlying income in the jurisdiction. Credit systems also do not adequately protect loss-making entities that are unable to use such credits and exacerbate the challenges with credits and credit carryforwards that have been flagged as a significant barrier to the adoption of Pillar 2. MDSH uses an exemption system to adjust for profits subject to tax, so there is currently a lack of consistency within the draft rules. Credit rules are based on the assumption that both jurisdictions have taxing rights. Therefore, credit relief is inconsistent with the basic premise that Pillar One is about reallocation of taxing rights from one jurisdiction to another. This needs to be reflected in the Elimination method.
Schedule I	Elimination Tax Base	The progress report contemplates detailed book to tax computation rules for the determination of the elimination profit of a Covered Group in each jurisdiction, with consolidated accounts as a starting point. The rules are extremely complex and will require a huge amount of investments in IT tools and resources, without any possibility to apply simplification measures contrary to the Safe Harbors that are contemplated for Pillar 2. Moreover, they are not consistent with Pillar 2 Globe Income / Loss computation rules,	There continues to be different viewpoints among *Business at OECD* (BIAC) members on whether the P1 and P2 tax base need to be aligned. However, our members generally agree that the tax base within P1 should be aligned. Ideas suggested by Members include: • A simplified PBT calculation based on IFRS/US GAAP could be the starting point for the computation of Elimination Profit. - Contrary to Pillar II rules, which aim at measuring a common ETR in all countries and therefore require a common book to tax calculation, the Elimination Profit in Pillar I aims at measuring a return on depreciation

Section	Topic	Issue	Recommendation
		which means that a new set of tax books would need to be maintained in each country, in addition to the statutory accounts, the consolidated accounts, the local tax books and the GloBE tax books. Among the inconsistencies: • Most of the adjustments that are contemplated are mandatory, whereas they are optional in GloBE rules (e.g., Stock-Based compensation adjustment) • Other adjustments which exist in Pillar 2 are missing (e.g., FX adjustment when the functional currency is different in local tax books and consolidated accounts) • Intercompany transactions within the same jurisdiction must comply with the arm's length principle, whereas in GloBE rules an election can be made to treat all the entities within the same territory as one, provided that a tax consolidation mechanism exists in the jurisdiction. • A mandatory Elimination Loss carryforward mechanism is created, whereas in Pillar 2 the use of a GloBE loss carryforward is only an election. Not having alignment with P2 means we are creating a fifth set of books (Stat, Tax, GAAP, P1 & P2) for each legal entity. This for all the	and payroll costs. There is no need to go into a detailed book to tax calculation. - Today, under transfer pricing adjustments, the starting point to determine an excess profit is unadjusted management accounts, not a detailed tax computation. • Start with book and apply elective adjustments (similar to P2) and apply the adjustments consistently across P1. At a minimum, we encourage the TFDE to review differences in base measurement, both between two pillars as well as within Pillar One. Any differences should be confirmed as necessary to achieve stated policy goals, and in the case of differences within Pillar One, safeguards should be introduced to ensure that differences do not result in double taxation (for instance, due to differences in the measurement of Adjusted PBT for purposes of computing Amount A and the measurement of Elimination Profit for purposes of the allocation of the Elimination of Double Taxation). With respect to safeguards, we suggest that the relieving mechanism include a backstop of some sort to ensure that as a last step in the allocation and elimination analysis, all Amount A is effectively relieved from double taxation, by either adjusting the amount of Amount A allocations or adjusting the relieving obligations of Relieving Jurisdictions. We also recommend to clarify whether P2 safe harbours are applicable in respect of In-scope MNEs, and to consider P1 Elimination tax base related issues for the design of relevant P2 safe harbours.

Section	Topic	Issue	Recommendation
		entities of a group. The most worrying part is that the P1 and P2 groups will be relatively aligned to GAAP at the beginning but will vary greatly as the years pass given the numerous and significant adjustments (in particular in M&A situations and Fair value adjustments).	
Schedule I, Section 2, para 1	Elimination Tax Base - Adjustments	There's a lack of consistency between tax base of Amount A (IFRS based with some adjustments), MDSH (based on a limited amount of IFRS elements), and the elimination tax base (based on additional IFRS adjustment and non IFRS elements). There is also a lack of connection between the Y% and the elimination multiple. Inconsistency is bound to create unexpected outcomes, including double taxation if elimination jurisdictions do not have sufficient profit to offset Amount A liabilities. They can also deprive MNEs and countries of any visibility/predictability on the outcome.	
Schedule I, Section 2, para 3	Transfer pricing adjustments	Transfer pricing adjustments should be made by companies and countries following domestic legislation. The eliminations calculation should not have separate transfer pricing rules that could be applied, regardless of whether there are actual transfer pricing adjustments or the relevant countries even agree such adjustments are warranted. This rule under section 2.3 creates more	Only actual transfer pricing adjustments by countries should be included in the elimination calculation.

Section	Topic	Issue	Recommendation
		uncertainty and possibility for double taxation. It is interesting that in this context full telescoping is applied.	
Schedule F and Schedule J	Impairment losses; Consistency between elimination and tax base	Schedule F excludes impairment losses from the calculation whereas Schedule J (2) includes impairment losses when calculating the depreciation Amount. It's not clear as to why fixed asset impairment losses are treated differently within the Amount A calculations. However, this differing treatment introduces yet more compliance complexity.	Impairment losses can be seen as part of the economic cost of asset ownership and should be treated consistently within the Amount A calculation, also to reduce complexity and compliance costs. We suggest excluding impairment losses and replacing with the realization principle in all instances.

3.3. Withholding tax

We understand that the treatment of WHT is subject to further consultation, as there are currently divergent views on this topic among the delegates. Since this is a future discussion topic, we provide our suggestions and comments on WHT in prose below.

Withholding tax are an integral part of the international tax system and represent effective source-based taxation. Allowing taxation of the residual through WHT would act as a backdoor around the rules and objectives of Pillar 1, and would undermine the certainty provided by addressing taxation of residual profit through Amount A. Although WHT are not considered measures that would be withdrawn under the MLC, the overlap in taxation of residual profit between WHT and Amount A needs to be resolved through adjustments to Amount A. We believe that WHT needs to be taken into account in measuring the level of profit which has already been taxed in the country, as a WHT on royalty or other income is a way to tax a residual profit leaving the source market country.

We believe that in principle there are two issues created by WHT, at the relieving country side and the source / Amount A country side, and that both need addressing to solve the double taxation issue otherwise arising from WHTs on transactional flows between countries. Framing the discussion to require a solution within the determination of the elimination profit for the relieving country side and within the determination of the effective

Amount A allocation (either part of the MDSH or otherwise) on the source country side makes sense. The fundamental challenge is that WHTs are linked to transactional flows between legal entities whereas Amount A is a formulaic calculation made at the country level.

More specifically on these two elements:

3.3.1. Relieving country that suffered WHT on income flows

We believe this principally raises two questions:

1. How to adjust downwards effectively the level of the elimination profit available for the relieving country?
2. What WHT to take into account in determining the level of downward adjustment to the elimination profit?

On question 1, it makes sense to adjust a jurisdiction's Elimination Profit by reducing it for the income needed to shelter the WHT. Making a distinction under the current set-up of Amount A, between income sheltered and not sheltered by WHT seems impossible and not advised, and hence simply adjusting the level of income available for relief (in mathematical manner) is preferred. We believe this can simply be done by an absolute amount downward adjustment to the elimination profit whereby the level of profit is calculated based on calculating the level of taxable income needed based on the relieving country statutory corporate tax rate and the level of WHTs to be sheltered. Such absolute downward adjustment is comparable in approach to the absolute amount adjustment, or multiple of adjustment, for the MDSH adjustment under article 6.6. We believe this is a simpler method than potentially making another complex adjustment to how country level RODP % is being calculated in the tiering exercise.

In terms of what WHT to take into account, this presumably boils down to two key questions: (1) WHT on what categories of income, and (2) is the manner of actual relief for the WHT in the relieving country relevant?

- We believe that the categories of WHT should not be limited to royalties but should also include services WHT (whether as cost recharge or value-based fee model) as the more obvious elements creating residual profits.
- However, a relieving jurisdiction under the elimination calculations could be a centralised treasury entity which finances the operating companies. This is another income stream that can trigger WHT, and therefore this raises the question of: in the context of an overall formulaic approach, why it would be reasonable to make a distinction between royalties and interest WHT?
- Furthermore, if WHT on only some income streams are taken into account, this preserves the potential incentive for source countries to introduce new WHT that would not be adjusted for under Pillar 1.

See further implementation suggestions in Appendix 1.

3.3.2. Source countries deducting WHT

- We believe this requires a mechanism that adjusts the return of the local entity by an amount calculated to set the WHT collected to an equivalent amount of profit taxed at the full corporate income tax rate. Similar to the above, we believe that limiting to royalties may be too narrow and hence at minimum would expect services WHT to also be taken into account, as they are the items subject to WHT most likely to be relevant for residual profits with a similar caveat of a significant portion of relieving income can also originate from centralised treasury activity.
- Using the approach above, the MDSH Adjustment that is deducted from the source country's Elimination profit (per article 6.6) is also reducing the amount of potential profit that the source country must relieve under Amount A. To neutralise this, the additional deemed income stemming from WHT would also need to be added to the source country's Elimination Profit for EoDT.
- Instead of incorporating this into the MDSH calculation per prior paragraph to determine the level of Amount A allocation reduction, it could be considered to simply – before running the MDSH calculations as currently proposed – reduce Amount A first with WHT-associated income, and only thereafter do the MDSH in its current form. This has the benefit of not also mingling this discussion on solving the WHT issue with the discussions on Y%.
- Rather than look to tax treaties for definitions, it may be easier to reference the tax returns used to file the WHT as this will characterise the nature of the payment and therefore the WHT rate to be applied.
- The above approach would also cover non-treaty situations and has the audit trail that can be evidenced.

3.3.3. FX considerations

There is a general issue as to whether all of these calculations need to be made in local currency, especially if tying to a tax return filed. We believe that payments and relief for Amount A should be in functional currency of the Group to minimise hedging costs for the Group that may arise from Tax payables and Tax Receivables. Waiting to receive tax refunds in local currency from countries that have a highly depreciating currency will expose the taxpayer to real economic losses even though in principle there is no double taxation.

3.4. Others

Section	Topic	Issue	Recommendation
Overview , para 4	DSTs and relevant	It is currently planned that MLC will include a commitment not to enact DSTs. That commitment will not cover a certain number	While we recognize the policy intent here, we would like to make sure that such a carve out does not undermine the stability and integrity of the new P1 solution. The carve-out should be carefully and strictly drafted to ensure that Parties to the MLC do not have the opportunity to

Section	Topic	Issue	Recommendation
	similar measures	of taxes including 'rules addressing the abuse of existing tax standards'.	introduce anti-abuse legislation the outcome of which would be to undermine key features of the P1 solution (PE, profit allocation) in case they disagree with the practical outcome of the P1 solution. Also, it should be made clear that such DSTs cannot be essentially converted into withholding tax regimes to circumvent this commitment. Similarly, withholding taxes that are treated as covered taxes under tax treaties should be carefully examined to ensure that they do not contravene the key feature of Pillar One.
Overview, para 4	DSTs and relevant similar measures	The proposed definition of DSTs and relevant similar measures is too restrictive in several ways. First, it is a conjunctive "and" test – all listed elements must be present in order for a measure to meet the definition. We believe this is too restrictive given the factors listed in the Progress Report. For example, under the proposed rule, a measure must discriminate against foreign businesses to be defined as a relevant similar measure that must be repealed. A measure that applies equally to all companies, even if it is targeting the exact same policy intent as an Amount A allocation to the market jurisdictions, is permitted, meaning that the rule as proposed would result in a full array of DSTs and Amount A allocations in the same jurisdictions.	A multi-factor balancing test might be more appropriate instead of a conjunctive "and" test. Broadly and conceptually, if the tax in question applies to taxpayers and activities that would be taxable under Pillar One but that are not taxable under current commonly accepted international tax principles, the tax should be considered a unilateral measure. A tax should not be determined to not be a DST or relevant similar measure, simply because a tax authority asserts it is a rule "addressing abuse of the existing tax standards." A tax should still be treated as a DST or relevant similar measure, regardless of the stated intent, if it operates outside commonly accepted international tax principles. The rules should clarify that the relevant factors will be judged on both a de jure and a de facto basis, so that the practical effect of a measure is taken into consideration.

Section	Topic	Issue	Recommendation
Overview, para 4	DSTs and relevant similar measures	It is unclear whether subnational jurisdictions (e.g., cantons, provinces, states) are included in the MLC's obligation not to enact DSTs and relevant similar measures. However, subnational jurisdictions have a vital role to play in the stabilization of the international tax regime. While subnational jurisdictions might not be directly participating in the TFDE negotiations, each national government in the TFDE is responsible for its own internal governance in negotiating, agreeing to and complying with the OECD solution, and that includes all subnational jurisdictions. Otherwise, subnational jurisdictions could simply enact DSTs and relevant similar measures and completely eliminate the stability the international community has worked so hard to attain and which is indeed one of the fundamental goals of the OECD solution. A major incentive for governments and taxpayers alike in supporting Pillar One in the first place was the elimination of DSTs and relevant similar measures; if that fundamental concept is not honored, support for Pillar One will be severely damaged.	Subnational jurisdictions should be included in the MLC's obligation not to enact DSTs and relevant similar measures.
Title 2, Article 2, para 2	Impact of Tax charge resulting from	The paragraph starts with 'Income tax charged in accordance with this article'. §1 deals with the allocation of tax base to lead to a tax charge. §2 rightly aims at providing	However, since §1 actually refers to re-allocation of income, § 2 should provide that no reallocation of income is required, and that the reallocation of taxing rights and the resulting tax charge should not impact any other taxes.

Section	Topic	Issue	Recommendation
	P1 on other Taxes	that tax charge resulting from §1 should not have any impact on any other taxes.	
N/A	Amount B	It is unfortunate that Amount B has not progressed further and was not included in this report.	While we believe that the MDSH should be revised with connection to arm's length principles, if that is not accomplished, it will be essential to have a robust Amount B to fill that void and achieve this purpose. Amount B should be immediately available as a safeguard for all companies, whether or not they are currently a Group in scope of Amount A and regardless of industry, including those operating on a cost-plus basis, once Pillar 1 is effective. If more time is needed to perfect Amount B, that does not preclude a more general approach to Amount B that could be refined over time, and that would be consistent with the entire Pillar 1 project, in any case, since Pillar 1 in so many areas seeks to standardize calculations, rather than have highly customized approaches for each taxpayer.
Various For example, Schedule J, para 9.c Page 93	Definition of "Ordinary Operating Activities"	In several places, the Progress Report uses the phrase "ordinary operating activities". This phrase is used where the proposals in the Progress Report might be open to abuse and can be seen as Anti Avoidance Rules. The need for such rules is understood. The chosen phrase of "ordinary operating activities" is not defined in IFRS GAAP or elsewhere in the Pillar One proposals.	Recommend to either use terms defined in IFRS GAAP or make clear that this is not a financial statements term and provide guidance on its meaning.
Various	Data Source	The progress report uses several data points taken from the financial statements. To reduce complexity, it could be clarified that there is no requirement to disaggregate a single service invoice received to identify	Recommend to confirm there's no requirement to identify labor / fixed asset components of service costs.

Section	Topic	Issue	Recommendation
		separate components. For example, where a service provider charge includes an element of labour / fixed assets.	

4. Comments on existing building blocks

4.1. Revenue sourcing and nexus

Section	Topic	Issue	Recommendation
Title 3, Article 3, para 2	Nexus de minimis	If Jurisdiction GDP is <EUR 40b, the threshold is replaced with EUR 250k. This is an exceptionally low level of materiality that will create significant additional compliance – particularly when factoring in inflation, which can render this threshold to be nonsensical.	Either maintain the EUR 1m threshold regardless of GDP or at least provide some mechanism for adjusting the EUR 250k threshold annually for the effects of inflation.
Title 3, Article 4, para 2	Revenue sourcing	N/A. Further clarity sought.	Further clarity is sought on what it means that revenues must be sourced in a manner that accounts for differences among Jurisdictions in the goods, content, property, products and services sold, licensed or otherwise alienated and provided by the Covered Group, their quantities and their prices.
Title 3, Article 4, para 9a	Nexus for intangibles	The notion of place of use can be tricky, in particular in the R&D context. When IP is licensed to a third party, it may have several R&D hubs and we will have no way of knowing where the IP will be used. The notion of place of use should be replaced with/defined as invoice to. See further comments below on the related schedule.	See our comments to the revenue sourcing consultation. We suggest tracking IP to the place of sale of Finished Goods (in case of an already marketed product embedding the IP and if the information is readily available) or as a fallback place of use.
Schedule E	Detailed Revenue Sourcing Rules	Improvements to sourcing rules are welcome, and it is appreciated that OECD took	• We recognize that the OECD seriously considered feedback from the earlier consultation on sourcing. This highlights the value of the

Section	Topic	Issue	Recommendation
		feedback into consideration. Some of the rules, however, could be further clarified or present some practical challenges	consultation process, and we thank the OECD for being open minded and for listening to commentators on this point. • We note that the OECD has removed the reference to the transaction-by-transaction approach that we had previously highlighted could have led to many unintended practical problems. We remain concerned that given the structure of the rules, some taxpayers will still be required to source revenue on a transactional basis and think that this point requires further clarification in the additional guidance the TFDE is preparing. • Some examples that address practical issues for applying the revenue sourcing rules would be very welcome. Since different companies will have a variety of different types of data that they collect, some examples of how to use data and make appropriate adjustments for gaps in data would be highly instructive. We understand the Secretariat is working on providing additional examples in the upcoming Commentary. • It would be very helpful for the rules to provide some guidelines to reinforce that the objectives are to use reasonably available data or data collected in the normal course of business, so that companies do not have the impression that extraordinarily expensive systems overhauls or diversion of engineering resources are expected. This is particularly the case where data that is directionally similar is already reasonably available. We understand the Secretariat is working on providing additional clarification in the upcoming Commentary. • Large companies have many products and services, so there should be a materiality threshold for products with revenues below 5% of total revenues. The "Tail-End Revenues" concept in the progress report recognizes this in the context of a particular product / revenue type, but there should also be a threshold based on a company's total revenues. Any product below that threshold should have simplified approaches (e.g., billing address, allocation keys or use of sourcing percentages for the larger percentage of revenue from the business) for allocation to avoid a disproportionate amount of work for compliance and audit for immaterial revenue amounts.

Section	Topic	Issue	Recommendation
			• Also see our previous comments for de minimis simplifications. • We are encouraged that the OECD has further developed the concept of the Initial Transition Period. This will be a very important part of an effective certainty process. However, see our comments in the cover letter about lengthening the transition period beyond three years.
Schedule E	Detailed Revenue Sourcing Rules	We would like to confirm that there isn't a hierarchy of indicators to be used. For example, for revenues from other services derived from a Large Customer, one does not need to show that third party data as defined in para 2.b.i is not available (i.e., prove a negative) before moving onto Another Reliable Indicator or Alternative Reliable Indicator.	Such examples can be helpful in the Commentary, and the Commentary should be incorporated into the MLI in its entirety by reference to have the force of law.
Schedule E, Section 2	Definitions of Enumerated Reliable Indicator, Another Reliable Indicator and Alternative Reliable Indicator	The definitions include the necessity to establish that an alternative approach produces results consistent with the enumerated Revenue Sourcing Rule in question. The standard, if interpreted in a certain way, can be unreasonably high. How do we prove consistency of an indicator if we don't have the underlying data against which to compare it? This could be viewed as a toned-down version of a negative proof included in earlier discussion.	We understand the Secretariat is working on providing additional examples and clarification in the upcoming Commentary, and that it envisions the alternative approaches would produce results that are reasonably consistent with the intent/spirit of the overall revenue sourcing rules. Given the importance of this rule, we recommend that such clarifications are included in the model rules themselves.

Section	Topic	Issue	Recommendation
Schedule E, Section 2, para 3, b, ii	Reliability test	"the Indicator is relied upon by the Covered Group for commercial purposes or to fulfil legal, regulatory, or other related obligations".	Need to further clarify for this definition. To minimize controversy, this must be clear.
Schedule E, Section 2, para 9	Internal control framework	N/A.	The expectations for the Internal Control Framework should be reviewed as part of the early certainty process and there should not be a requirement that this framework is reviewed by the board of directors.
Schedule E, Section 3B, para 4	Reasonable Steps to Reduce Tail-End Revenue below 5%	Definition of Reasonable Steps is unclear and the obligation to reduce within 2 years.	As Reasonable steps is not defined/left for further discussion in Comments or other documents, the standard MNEs are committed to is unknown and could be an issue, all the more so if it results in some financial penalties/refusal to access some processes (Advance Certainty for instance). As a general matter, Reasonable Steps should not require groups to renegotiate contracts, including asking customers whether they would be willing to renegotiate.
Various	Reasonable Steps for sourcing decisions in general	The current document does not sufficiently define what reasonable steps are. That information is in the Commentary which will not have the force of law.	The OECD Commentary needs to be specifically incorporated by reference into the MLC so that its principles are part of the MLC and will carry the force of law. Otherwise, countries will be free to interpret these concepts as they see fit, resulting in a similar patchwork of rules that Pillar One is intended to avoid, and leading to many disputes. One good example is the sourcing of components where the draft rule requires sourcing to the consumer of the finished product which is rarely going to be possible. The commentary will provide simplified procedures to indicate the data does not exist so that the sourcing can be done by a global allocation key. This needs to be the clear rule and incorporated into the MLC.
Schedule E, Section 3B, para 5-6	Allocation of unsourced revenue	It is not clear where revenue is allocated "on a pro rata basis" to the Jurisdictions of the Independent Distributors, whether the allocation should be based on revenue, the number of distributors in each	Both these points should be clarified in amendments to the Model Rules or in additional commentary.

Section	Topic	Issue	Recommendation
		Jurisdiction, or some other basis. It is not clear what would be a reasonable basis to conclude that Finished Goods sold through Independent Distributors are primarily delivered to Final Customers outside the Jurisdiction of the Location of its Independent Distributor.	
Schedule E, Section 3C	Online Intermediation	What is the definition of online intermediation and how to distinguish from an online distribution function when Digital Content is involved?	A clear definition with examples should identify the difference between online intermediation and online distribution of digital content on a platform because the revenue sourcing rules are dramatically different. Online intermediation sources 50/50 between buyer and seller locations whereas digital distribution sources 100% to the buyer location.
Schedule E, Section 5	Components for pharma	As mentioned in our previous comment, components in the bio-pharma sector may be difficult if we sell Active Pharmaceutical Ingredients to another MNE that incorporates it in their own drugs.	See our comments to the revenue sourcing consultation.
Schedule E, Section 5	Components	Requiring component manufacturers to determine revenues based on the final customer of the final finished good places an undue burden and impossible standard for	The OECD previously acknowledged this challenge in its January 31,2020 statement, taking into account practical realities, "businesses selling intermediate products and components that are incorporated into a finished product sold to consumers would be out of scope".

Section	Topic	Issue	Recommendation
		component manufacturers to reasonably comply.	Components like semiconductors are sold in bulk and incorporated and substantially transformed by unrelated parties into an altogether different product (e.g., a mobile phone, a computer) or sold in bulk to a third party. While there may be a contractual relationship between the component manufacturer and the component distributor or the Finished Good manufacturer, there is no contractual relationship with or visibility into the multiple tiers of Finished Goods distributors, resellers or retailers down channel. As such, the taxpayer does not know the location of the third-party's Finished Good to the Final Customer. Without the ability to access the destination of the Finished Goods, it is impossible for a component manufacturer to determine the location where the Finished Good is sold to the Final Customer. As discussed above, companies should not be required to access information collected by another taxpayer (such as a customer or a customer's customer) in order to determine sourcing.
Schedule E, Section 5	Components	The proposed sourcing rules for components parts need to be revised to a standard that can reasonably and practically met. While the new rules provide some level of flexibility, they are overly complex and do not provide the required level of tax certainty	The intricate requirements around the suggested Indicators or Allocation Keys do not present a reliable method to ensure tax certainty for businesses involved. Therefore, we would recommend that for components, the "*revenues derived from a transaction for the sale of Components are deemed to arise in [a Jurisdiction] when the Component is sold to the direct customer of the Component manufacturer*" as the "sold-to" information is the most reliable and reasonable indicator that the component manufacturer collects pursuant to its commercial and legal obligations.
Schedule E, Section 6, B	Revenues from Online Advertising Services	The transaction-by-transaction approach on which the rules still seem to be based is particularly difficult to apply for online advertising, given the volume of transactions that occur in this industry.	As part of additional guidance further consideration should be given to how the compliance costs associated with the application of these rules can be minimized, including the use of statistical methods in some circumstances.

Section	Topic	Issue	Recommendation
Schedule E, Section 6, F	Revenues from Other Services	N/A. Additional suggestion provided.	"Revenues from Other Services" should include as a possible enumerated indicator any location data for end users collected for financial purposes by the company in the ordinary course of business. Also need clarity that cloud services are "other services".
Schedule E, Section 7, A	Nexus rules for IP	The recourse to a different treatment for Large Intangible Property Contract might be problematic.	No penalties should arise to the MNE that have relied on this third-party information in case of error. This comment is applicable for any sourcing rules that are based on third party information not under the control of the MNE relying on it. Nexus rules for IP still do not reflect timing difficulties between payments and reality of nexus. Upfront payments or milestones usually represent potential future value and will be sourced under current year sales.
Schedule E, Sections 9 & 10	Non-Customer Revenues and Governmental Grants	These appear to require reclassing of other types of income or reduction in expenses into Revenue which will not tie to the financial statements	The rules should clearly state that these categories should only be used for items that are recorded under the accounting rules as Revenue. If they are recorded elsewhere in the P&L there is no requirement to reclass them to Revenue for this purpose.
Schedule E, Section 10 and relating definition in Section 12, para 70	Non-Customer Revenues nexus	The allocation of Non-Customer Revenues is done in proportion to the allocation of other defined revenues. This means a complete disconnect between the place where functions/costs are borne to generate those revenues and where they will be taxed under amount A. This will not necessarily be adequately protected by the MDSH.	The first question should be whether those revenues should be included in the base of Amount A as they are not directly market driven. If they remain in scope, they should be traced back to the jurisdiction that functionally and economically has borne the costs to generate them. Inclusion of asset sales (see comments above). Only third-party customer revenue should be in scope.

Section	Topic	Issue	Recommendation
Schedule E, Section 11, para 71	Length of "Initial Revenue Sourcing Transition Phase"	The Transition phase is restricted to the first three years after the entry into force of the Multilateral Convention (MLC). We understand another three years of soft-landing transition may be available after the initial 3-year transition period.	Support the proposed inclusion of the Transition Phase. Still, we believe that given the complexity and novelty of this new taxing right, the transition period should extend until the point that a taxpayer has concluded its early certainty process and have had time to modify its systems to obtain reliable data (e.g., 7 years to align with the scope expansion and review). Additionally, the entire Transition Phase concept appears targeted solely at Groups that are in-scope at the time the MLC becomes effective. The definition should be expanded to address Groups that become in-scope after that date, including those that become in-scope once the thresholds are reduced in 7 years, as they will have the same transition difficulties (systems issues, information gathering, etc.) at that time as Groups that are in-scope at the time the MLC becomes effective. As such, for Groups that are not in-scope at the time the MLC becomes effective, the definition should be expanded to include the first three years in which a Group is in scope.
Schedule E, Section 12, para 12	Definition of component (vs. definition of finished goods)	The progress report is still not fully clear on what constitutes a finished good vs. what is a component. We understand from the Secretariat that this will be clarified through examples in the Commentary to Amount A. However, we are concerned that the Commentary may not have a legislative value in many countries, thereby opening the door to unnecessary disputes.	We therefore strongly encourage the Secretariat and the TFDE to give legal value to the clarifications and the examples by inserting them in the Multilateral Convention for Pillar I.
Schedule E, Section 12, para 15	Knock-out rule	We are concerned about the possibility of very burdensome diligence required to apply the	The knock-out rule should be limited to legal and regulatory restrictions to sell in a jurisdiction. Anything beyond that, including commercial decisions, would be difficult to track and apply.

Section	Topic	Issue	Recommendation
		"Knock-Out Rule". It is difficult to prove the negative.	The TFDE can also consider an elective application of the knock-out rule.

4.2. Tax base

Section	Topic	Issue	Recommendation
Title 4, Article 5, para 2J	Treatment of JV's or other consolidated entities with noncontrolling interests	We continue to not understand the policy behind treating 50/50 JV's differently from other JV's or other consolidated entities with noncontrolling interests. 50/50 with joint control receive proportional treatment for both the allocation of Amount A and for the elimination of Amount A while 51/49 JV's (and other majority-controlled entities) include 100% of the profits of the JV or other consolidated entity in both the allocation of Amount A and the elimination.	We note the placeholder at Title 4, Article 5, para 2(j). The treatment of JV's or other consolidated entities with non-controlling interests should be proportionate to the majority shareholder's interest for both the determination of Amount A and the Elimination. If under the accounting method, 100% of the revenues of the JV or other consolidated entity with non-controlling interests are reflected in the majority owner's financials, revenues should be adjusted downward to reflect only the majority owner's interest percentage in the JV or other consolidated entities to align revenue and profits. The current approach will distort the economics between JV partners or the minority investors in the other consolidated entities.
Title 4, Article 5, para 2; Schedule F & G	Acquired Equity Basis Adjustments are creating a complex undue burden on MNEs	Schedule G requires the historic accounting basis to be used. In practice this means reversing any acquisition adjustments that have been pushed down to the entity.	Clarify that this only apply to acquisitions made post the implementation of Pillar 1.
Title 4, Article 5, para 2	"Asset Gain Spreading Adjustments"; exclude pre-implementation gains.	The Progress report introduces the "Asset Gain (or Loss) Spreading Adjustments", i.e., book-to-tax adjustments required to ensure that the gain (or loss) recognised upon the sale of an asset such that this gain (or loss) is allocated evenly between	Recommend to clarify that pre-implementation gains related to asset deals (i.e., gains incurred prior to the introduction of Amount A). are excluded or made optional.

Section	Topic	Issue	Recommendation
		the Period in which the gain (or loss) arises and the four subsequent Periods. Special attention is likely needed in relation to pre-implementation gains related to asset deals (i.e., gains incurred prior to the introduction of Amount A). [2] Any carry forward regime that would also cover this period could potentially bring these pre-implementation gains within the scope of Pillar One for the years 2024 and following.	
Title 4, Article 5, para 3	Deduction of Net Losses	Limitation to 10 years & creation of a new class of DTA. "Pre-regime" losses incurred before Pillar One implementation may be carried forward only to the extent incurred in the 3 years prior to implementation. Loss carryforward in countries can extend beyond 10 years. As a result, there may not be sufficient elimination profit in these countries if Amount A losses are only carried forward for 10 years. Relieving jurisdictions should be able to fully recover prior losses, before allocations of profit are made to market jurisdictions – otherwise, one jurisdiction will grant a deduction and another jurisdiction will end up taxing the resulting profits.	The limitation of NOLs (including pre-regime NOLs) does not seem warranted by any policy rationale and should be unlimited. This new carry forward possibility, which is a good thing, will most likely result in the creation of DTA in the IFRS books of MNEs. We are wondering how those DTA will be handled under P2.

[2] This seems similar to losses under P1/ Amount A.

Section	Topic	Issue	Recommendation
Title 4, Article 5, para 3	Profit Shortfalls	Unlike the Blueprint and original consultation, the concept of profit shortfalls in the measurement of the Amount A tax base appears to have been eliminated.	A profit shortfall carryforward mechanism is logical, and should be included in the MLC and Model Rules. Regular domestic tax regimes tax profits above a 0% profit margin, so that 0% margin is the dividing line below which domestic losses and loss carryforwards are defined. Amount A taxes profits above a higher profit margin (10%) so that higher profit margin should be the dividing line below which Amount A losses and loss carryforwards are defined, i.e., in a profit shortfall carryforward mechanism.

4.3. Scope

Section	Topic	Issue	Recommendation
Title 1, Article 1, para 2	Revenue test for FY shorter or longer than 12 months	Proportionality principle to be applied	We had suggested to have the option to apply real data if available. This does not seem to have been picked up. Will it be handled in commentaries?
Title 1, Article 1, para 2	In and out of scope	The mechanism does not lead to out scoping MNE on the verge. A MNE can remain in scope even if there are effectively no tax due based on carried forward losses – this leaves a heavy compliance burden for both MNEs and Parties to MLC.	See our comments to the Scope consultation.
Schedule A, para 4a	Scope rules for entities not producing IFRS	MNE that do not use IFRS/GAAP need to prepare IFRS accounts to determine if they are in scope.	MNEs are in scope if they meet the criteria. If they don’t prepare IFRS (or equivalent), they will now have the obligation to prepare them to demonstrate they are not in scope. This is placing a significant burden on out-of-scope MNEs.

4.4. Extractives exclusion

Para	Topic	Issue	Recommendation
Comments on Substantive rules on Amount A			
Article 1.9	Covered Segment of a Qualifying Extractives Group	In determining whether a Disclosed Segment reported by a Qualifying Extractives Group is a Covered Segment, Article 1.9 incorrectly refers to the "non-Extractives segment revenue test" and the "non-Extractives segment profitability test" as being "contained in Section 12 of Schedule B." The relevant tests are contained in Section 11 of Schedule B.	In article 1.9 replace the reference to Section 12 of Schedule B with Section 11 of Schedule B.
Schedule B			
1.1	Overview	First line refers to the application to a Group or a Disclosed Segment which is a Qualifying Extractives Group however the definition of Qualifying Extractives Group in 20.1 is centred on a "Group"	Suggest "This schedule contains the rules that govern the application of this Act to a Group which is a Qualifying Extractives Group or a Disclosed Segment within a Group which is a Qualifying Extractives Group"
2.4	Merger and Demerger	Incorrect reference in 2.4. Refers to 3(b) and 3(c). 3(c) does not exist.	Replace references in 2.4 with 3(a) and 3(b) if that is the intent or include the missing reference and consider whether key information has been omitted.
2.5	Shortcuts	Four different shortcuts are provided to remove the requirement to apply 2.2 in full	We support the use of shortcuts as they significantly reduce the compliance that would otherwise result from the complex rules. In the case of MNEs in the Oil and Gas industry, a turnover of Euro 20B from non-extractive revenue is common. Therefore, even after the application of the shortcut, most oil and gas majors will have to proceed to non- Extractives profitability test. We therefore recommend to also include a profitability shortcut that would allow a simplified calculation based

Para	Topic	Issue	Recommendation
			on public Consolidated Financial statements (Example to follow) Separately, the OECD's flexibility in allowing an MNE to choose to apply the Extractive Segment or Extractive Entity approach is helpful and appreciated.
2.5	Shortcuts (a) – (d)	The shortcuts proceed on the basis that you look at the revenues of either Extractives Segments/ Entities OR Non-Extractives Segments/Entities. For sub-para's (a) and (b) we assume the intention is as simple as you add up the revenues of each Extractives Segment or Extractives Entity (as is your choice), deduct them from the Revenues of the Group (note drafting point below in respect of sub-para (b)) and then compare the result to the 20bn revenue test. Likewise for sub-para's (c) and (d) you add up the revenues of each Non-Extractives Segment or Non-Extractives Entity and compare the result to the 20 bn revenue test. There are a number of drafting questions in relation to this: 1. We assume that for the purposes of the shortcuts the intention is that you are simply focused on the total revenues of the segment/entity – i.e., you are not trying to isolate extractives revenues –e.g. rather you remove the whole of the entity/segment's revenue once you determine it is an extractive entity or segment; 2. Where the shortcut requires the deduction/addition of revenues of a segment/entity for the purposes of determining Non-Extractives Revenues under the shortcut, and this <u>does not include</u> the revenues related to sales to other segments/entities for downstream processing, the	To address points 1 to 5: **Section 2.5(a)** Amend 2.5(a) to add: *"… revenues included in the Consolidated Financial Statements that are reported by one or more Extractives Segments (reduced by any Intra-Group Extractives Segment Revenue)…"* Intra-Group Extractives Segment Revenue is defined as: *"Revenue of Extractives Segments derived from transactions with other Extractives Segments in the Group"* **Section 2.5(b)** Clarify that revenue per the stand-alone accounts of Extractives Entities is to be deducted from Group revenue for the purpose of 2.5(b) which should read as follows: *"Deducting from the revenues of the Group the revenues that are reported in the financial statements of Extractive Entities (reduced by any Intra-Group Extractive Entity Revenue)…"* Intra-Group Extractive Entity revenue is defined as: *"Revenue of Extractive Entities from transactions with other Extractive Entities in the Group".*

Para	Topic	Issue	Recommendation
		deduction/addition of revenues will be understated, thus reducing the efficacy of the shortcut; 3. The revenues of a segment/entity on a standalone basis will usually include revenues that relate to sales to other segments/entities for downstream processing. We assume that to the extent that there are activities as part of an integrated supply chain, the application of the ALP is not part of the shortcut but rather is something that will be taken into account in determining whether the segment/entity is an Extractives Segment or Extractives Entity or vice versa, is a Non-Extractives Segment/Entity – the shortcut is simply looking at the revenues of the segment/entity as per the accounts; 4. Where there is an integrated supply chain across multiple segments/entities the focus on revenue within the shortcuts could result in the double counting of revenues which could either over-inflate the outcome under (a) or (b) (in the company's favour) or over-inflate the outcome under (c) or (d) (not in the company's favour). This arises because the revenue related to the same underlying product within the supply chain will be reflected in the revenues of the multiple segments/entities. For example – if a company has bauxite, alumina and aluminium segments (as part of an integrated supply chain), revenues related to bauxite will be implicitly reflected in the revenues of all 3 segments. 5. Related to this, in 2.5(a) and (b) it is not clear what the term "the revenues included in the Consolidated Financial Statements that are earned ["derived" is used in (b) rather than "earned"] by one or more Extractives Segments/Entities…" means, noting that the consolidated accounts will be the product of an elimination of the revenue/expense related to the intra-group transaction	The additional words in brackets and the definition are intended to eliminate double counting of revenues from integrated supply chains i.e., the revenue that is the counted is the sale from the extractives entity to the non-extractives entity. Similar amendments can be made for 2.5(c) & (d), as follows: **Section 2.5(c)** Amend 2.5(c) (for consistency with section 2.5(a)) to add: "*Aggregating the revenues of all Non-Extractives Segments reported in the Group's financial statements (reduced by any Intra-Group Non-Extractives Segment Revenue)*" Intra-Group Non-Extractives Segment Revenue is defined as: "*Revenue of Non-Extractives Segments derived from transactions with other Non-Extractives Segments in the Group*" Note: the proposed defined term of "Intra-Group Non-Extractives Segment Revenue" is similar to the existing defined term "Non-Extractives Intra-Group Segment Revenues" at section 19.5 (but has a different meaning). To the extent these are too closely matched an alternative term can be used (for either definition). **Section 2.5(d)** Amend section 2.5(d) (for consistency with section 2.5(b)) to add: "*Aggregating the revenues that are reported in the financial statements of Non-Extractives Entities (reduced by any Intra-Group Non-Extractive Entity Revenue)…*"

Para	Topic	Issue	Recommendation
		between the segments/entities. Strictly speaking, intra-group revenues are not "revenues included in the Consolidated Financial Statements". A literal interpretation of this phrase would render the short-cut ineffective because it would mean, for example, that a sale by an entity in an extractive jurisdiction to an intermediary entity in another jurisdiction (a non-extractive entity), before the product is sold to a customer, will not be deducted under the 2.5(b) because the revenue in the standalone accounts of the extractive entity is not "revenue included in the Consolidated Financial Statements" (i.e., because it is eliminated on consolidation). This approach would understate the revenues of the Extractives Segments and Entities because it will mean that the intra-group (Extractive) revenue is not counted for the purposes of the shortcut;	Intra-Group Non-Extractive Entity Revenue is defined as: *"Revenue of Non-Extractive Entities from transactions with other Non-Extractive Entities in the Group".* Note: the proposed defined term of "Intra-Group Non-Extractive Entity Revenue" is similar to the existing defined term "Non-Extractives Intra-Group Revenue" at section 10.10 (but has a different meaning). To the extent these are too closely matched an alternative term can be used (for either definition).
		6. Sub-para (d) refers to "Aggregating the revenues of all Non-Extractives Entities reported in their financial statements..." We assume this is referring to the aggregation of revenues per the standalone accounts of the relevant entities. 7. 2.5(b) refers to deducting revenues but does not state what they should be deducted from (unlike test a, which explicitly refers to "Revenues of the Group"). 8. Incorrect references in 2.5(a) to 2.5(d). In such cases, the Group is not required to calculate its Non-Extractives Revenues as defined by Section [10(12)] – instead of Section	6 . To clarify this reference is to the stand-alone accounts (and in any other places where it is relevant) to make this clear. In this regard, we note Schedule I contains the definition of "Entity Financial Accounting Profit (or Loss)" – this definition should be adopted for other purposes of the rules (outside of Schedule I), where it is relevant. 7. Addressed through amendments to 2.5(b) above 8. Replace references in 2.5(a)-(d) to 10(13) with 10(12)

Para	Topic	Issue	Recommendation
		10(13). Section 10(12) defines Non-Extractive Revenue. Section 10(13) defines Non-Extractive Segment.	
5	Revenue sourcing rules	It is not clear from the document whether products sold by Extractives Groups are Finished Goods or Components. A worst-case scenario would be these products to straddle both definitions – i.e., some products are Finished Goods whilst others are Components. Preference for products sold by Extractive Groups to be categorised as Finished Goods on the basis that the final customer is the sale by the Extractives Group to its customer. The overwhelming majority of transactions related to products sold by Extractive Groups are B2B. Only a very small portion is sold directly to Final Customers or via distributors. In the case of Components, given the homogeneous nature of the commodities purchased and sold, and the fact that these commodities may be resold multiple times between different industry counterparts before ultimately making their way into finished goods, it will be impossible to identify the place of delivery to a Final Customer of the finished good.	Clarification to be provided. Significant compliance savings will be achieved by specifying that products sold by Extractive Groups are one or the other – i.e., an Extractive Group will not have some products that are Components and some that are Finished Goods. We believe sound policy arguments could be made to support a position that Extractive Products are Finished Goods – we would be happy to discuss further. Where it is determined that some/all products sold by Extractive Groups are Components, a Global Allocation Key will need to be maintained in perpetuity – any other approach is implausible given the complexity of the downstream supply chain and diversity of use of Extractive Group products.
6.3	Non-Extractives Financial Accounting Profits	Typo "Non-Financial Accounting Profit (or Loss)" should be "Non-**Extractives** Financial Accounting Profit (or Loss)"	Correct accordingly
6.3	Determining the Non-Extractives	Section 6.3 outlines the Disclosed Segment Approach for calculating the Non-Extractives Financial Accounting Profit (or	Amend section 6.3 to clarify that the Non-Extractives Financial Accounting Profit (or Loss) of the Group is calculated by starting with the Financial Accounting

Para	Topic	Issue	Recommendation
	Financial Accounting Profit (or Loss) – Segment Approach	Loss) "*… by taking the Financial Accounting Profit (or Loss) of the Group and sequentially performing the adjustments under paragraphs 4 to 6.*" Where there are multiple Segments with different classifications, clarification is needed around the method for sequentially performing the adjustments in paragraphs 4 to 6 and aggregating the results to arrive at a single number for the Financial Accounting Profit (or Loss) of the Group. For example, the profit calculation for both Extractives Segments and Mixed Segments require starting with the Financial Accounting Profit (or Loss) of the Group and making subsequent adjustments. On a plain reading, this would suggest the Financial Accounting Profit (or Loss) of the Group is counted twice when trying to combine the outcome of each Segment, whereas we understand the intention is to start with Financial Accounting Profit (or Loss) of the Group and then only aggregate the adjustments in subsections 4(a)-(f) and 6(a)-(d) to arrive at the Non-Extractives Financial Accounting Profit (or Loss).	Profit (or Loss) of the Group and aggregating each of the adjustments that are contained in the subsections of paragraphs 4 to 6 (as relevant). In paragraphs 4 and 6, suggest removing the reference to the Financial Accounting Profit (or Loss) of the Group, given this is already stated in paragraph 3.
6.4(a)-(b)	Determining the Non-Extractives Financial Accounting Profit (or Loss) – Segment Approach (Simplification)	The calculation of Non-Extractives Financial Accounting Profit/Loss requires the revenue and costs of Extractive Segments to be excluded separately from the Group's profit.	It would be beneficial for MNE Groups if they could rely on the EBIT for Extractive Segments as reported in the Group Accounts for the purposes of excluding all revenues and all costs from Extractive Segments that are required to be deducted from the Group's profit in determining the non-Extractives Financial Accounting Profit (or Loss).

Para	Topic	Issue	Recommendation
6.4(c)	Determining the Non-Extractives Financial Accounting Profit (or Loss) – Segment Approach	Non-Extractives Financial Accounting Profit/Loss is calculated by taking the group Profit/loss and "excluding all costs included in the Consolidated Financial Statements that are incurred by the Extractives Segment" - the use of the terms "cost" and "incurred" are tax concepts which do not marry well to the accounting concept of "expense" and could result in anomalies – e.g., amortization is not a "cost" which is "incurred". [The same point is applicable to 6.6 in respect of Mixed Segments. The same point is also relevant to 6.7 in respect of the Entity Approach.] Use of the word "costs" is appropriate when used in reference to intra-group transactions.	Use "Extractive Expenses" (definition in Section 10.2 to change) for the relevant sub-paras (see further below). The same principles should apply to 6.6 in respect of Mixed Segments – "excluding Extractives Expenses of the Mixed Segment included in the Consolidated Financial statements". The same principles should be applied to 6.7 in respect of the Entity Approach – i.e., "deducting the Non-Extractives Expenses of the Group and Non-Extractives Intra-Group Costs of the Group".
6.5	Pre-Tax Profit Margin of the Non-Extractives Segment	The "Pre-Tax Profit Margin of a Non-Extractives Segment" is not defined in the rules, and it is unclear how this should ordinarily be calculated absent the transition rule.	Clarify the process for calculating the "Pre-Tax Profit Margin of a Non-Extractives Segment" (ignoring section 21.1(b)). Note: if you are meant to split the phrase into two separate defined terms i.e., "Pre-Tax Profit Margin" and "Non-Extractives Segment", then the "Pre-Tax Profit Margin" definition in Article 10 doesn't appear to work here as that definition specifically refers to the Pre-Tax Profit Margin of the **Group**. If it is intended that the definition in Schedule D Section 9.10 is to apply it would be helpful to clarify this. Please also note our related comments in relation section 21.1(b) below.
6.4 – 6.6 (plus Sectio	Determining the Non-Extractives Financial	The calculation of Non-Extractives Financial Accounting Profit/Loss requires an adjustment for Unallocated Income and Unallocated Expenses.	To reduce the complexities for calculating Non-Extractives Financial Accounting Profit, it would be beneficial for MNE Groups if they had the option to exclude the adjustment for Unallocated Income and

Para	Topic	Issue	Recommendation
n 15 for Covered Segments)	Accounting Profit (or Loss) – Segment Approach (Simplification)		Unallocated Expenses where Unallocated Expenses exceeds Unallocated Income and thus any adjustment would only reduce the Amount A reallocation the outcome. Alternatively, it would also be beneficial if no adjustment was required if the dollar value of Allocated Income is below a certain percentage of Group Revenue.
6.7	Determining the Non-Extractives Financial Accounting Profit (or Loss) – Entity Approach	Where a Group chooses the Entity Approach, the Non-Extractive Financial Accounting Profit (or Loss) of the Group is calculated as: • (+) "Non-Extractives Revenues" • (+) "Non-Extractives Intragroup Revenues" • (-) "Non-Extractives Costs" • (-) "Non-Extractives Intra-Group Costs" This calculation relies on the same definition of "Non-Extractives Revenues" used for the purposes of the non-Extractive revenue test in section 2.2. Broadly, a Group's "Non-Extractives Revenues" are equal to the Revenues of the Group after the deduction of all "Extractives Revenues" (section 10.12). In determining Extractives Revenues, where Group revenue derived has involved an intra-group cross-border transfer prior to sale, we understand the Arm's Length Principle should be overlayed by adjusting Group revenue to reflect the arm's length revenue of the Entity in the Jurisdiction of Extraction. In this circumstance, the Arm's Length Principle should often have the effect of reducing the Non-Extractives Revenue. Where the cross-border sale price is in accordance with the Arm's Length Principle (this will often be the case), the reduction to Non-Extractives Revenue will be equal to the intra-	Rather than use the definition of Non-Extractives Revenues in determining the Non-Extractive Financial Accounting Profit (or Loss) of the Group, use a different definition which does not overlay the Arm's Length Principle in determining non-extractives revenues e.g., *"the sum of revenues of all Non-Extractives Entities"*

Para	Topic	Issue	Recommendation
		group revenue recorded by the Entity in the Jurisdiction of Extraction. This should also be same amount that is recorded as a "Non-Extractive Intra-Group Cost" from the perspective of the Entity that is outside the Jurisdiction of Extraction (i.e., a Non-Extractive Entity). Accordingly, in determining the Non-Extractive Financial Accounting Profit (or Loss) under section 6.7, this can lead to scenarios where the same intra-group amount is effectively deducted twice i.e., first when applying the Arm's Length Principle to reduce Non-Extractives Revenues and again when subtracting Non-Extractives Intra-Group Costs.	
Section 10	Definitions relevant to Sections 1-9	"Extractives Cost" is defined as a cost directly or indirectly incurrent in the conduct of Extractives Activities etc. As noted above, "Cost" and "Incurred" are not appropriate when referring to the accounting profit/loss of an extractives business. This will not capture all expenses that result in the accounting profit/loss related to the extractive activity – for example amortization of fixed assets is not a "Cost" "Incurred" in the conduct of Extractives Activities but is an implicit part of the net accounting position of the extractives activities. Use of "Cost" and "Incurred" will likely result in expenses that relate to the extractives activities remaining in the Non-Extractives Financial Accounting Profit (or Loss) or Non-Extractives Net Losses under 6.9. An issue also arises in respect of the term "Non-Extractives Costs" due to the reference to "less the portion of those total expenses incurred by an Extractives Entity". "Extractives Entity" requires a Group Entity for which 75% of revenues are Extractives Revenues – this limits the Extractive Expenses that will be deducted in determining the "Non-Extractives Costs".	As suggested above, use the terms "Extractives Expenses" and "Non-Extractive Expenses" Suggested definitions: *"Extractive Expense" means an expense relating to the conduct of Extractives Activities or the derivation of Extractives Revenues.* *"Non-Extractives Expense" of a Group for a Period means the total expenses of the Group deducted in calculating the Financial Accounting Profit (or Loss) of the Group less Extractive Expenses.*

Para	Topic	Issue	Recommendation
10.5, 10.6 and 10.13	Definition of Extractives Segment, Non-Extractives Segment and Mixed Segment	All of these definitions rely heavily on the definition of Extractives Revenues and it is important that the application of the Arm's Length Principle is clear in the determination of whether a segment is Extractives, Non-Extractives or Mixed.	See comments below on the definition of Extractives Revenue
Section 11.2	Non-Extractives segment revenue test	In determining whether the non-Extractives segment revenue test is met under section 11.2, the definition of "Non-Extractives Segment Revenues" at section 19.8 means "*the Segment Revenues of the Covered Segment for the Period after the deduction of all revenues reported in the Covered Segment that are derived by Segment Entities that meet the definition of Extractives Entity*" We interpret this definition to mean the revenues of each Segment Entity that is an Extractive Entity should be determined based on the stand-alone financial accounts (and deducted from the Segment Revenues to arrive at Non-Extractives Segment Revenues). Where there is an integrated supply chain within the Segment, the revenues of an entity on a standalone basis will usually include revenues that relate to sales to other entities within the Segment for downstream processing. This could result in the double counting of revenues, meaning the Non-Extractive Segment Revenues are understated. This is similar to the issue outlined above in relation to the non-Extractives revenue test using the shortcut methods in section 2.5.	Clarify that revenue per the stand-alone accounts of Segment Entities that are Extractives Entities is to be deducted from Segment Revenue for the purpose of section 19.8 (if this is the intention), which should read as follows: *"… the Segment Revenues of the Covered Segment for the Period after the deduction of all revenues reported in the financial statements of Segment Entities that meet the definition of Extractives Entity (reduced by any Intra-Group Extractive Entity Segment Revenue)…"* Intra-Group Extractive Entity Segment Revenue is defined as: *"Revenue of Extractive Entities from transactions with other Extractive Entities in the Segment".* The additional words in brackets and the definition are intended to eliminate double counting of revenues from integrated supply chains within a segment i.e., the revenue that is the counted is the sale from the extractives entity to the non-extractives entity.

Para	Topic	Issue	Recommendation
Section 20	Definitions of Qualifying Extractives Group	The production of hydrogen from natural gas is considered to be a primary processing activity (page 45 of the report), therefore, an eligible group may include this production as extractive revenues. However, to be eligible, a group must extract the natural gas which is used for the hydrogen production. Whilst we welcome the ability for oil and gas producers to benefit from the exclusion on this activity, we see no reason why other hydrogen producers should not benefit from the carve out as well, up to the amount of their hydrogen revenues. Some businesses buy natural gas from third parties in order to produce hydrogen which is sold to Large Industry customers. These groups also make significant investments in green and blue hydrogen as part of the energy transition and are key actors in carbon capture technologies, which is also mentioned in the progress report. Hydrogen production is a highly local activity, which should not be subject to Amount A, whether the group is extracting the underlying natural gas or not.	Expand eligibility for the extractives exclusion to all types of hydrogen production and all types of groups producing hydrogen, up to the amount of their hydrogen revenues.
20.12	Primary Processing	The definition of "Primary Processing" includes a definition ("means"), which contains an inclusive positive list (i.e., list of products which are considered to be obtained from "Primary Processing" and a negative test ("does not include"). "Primary Processing" means processing undertaken to … liberate an "Extractive Product" from its natural state…." A literal interpretation of the current drafting will result in uncertainty for the following reasons:	MNEs would benefit from certainty around the commodities/products excluded from P1. For the avoidance of doubt, we recommend the rules are supported by an expanded list of commodities which meet the scope of the extractives exclusion. Use the term "Eligible Processing" instead of "Primary Processing" to better align the terminology to the policy

Para	Topic	Issue	Recommendation
		1. The term "Primary Processing" is relatively widely used term which implies the initial (aka "primary") processing of a raw material. This is inconsistent with the apparent intention in terms of scope of permitted processing for the purposes of the exclusion – for example, aluminium is specifically mentioned as being on the positive list and yet is the product of processing that occurs beyond the commonly used meaning of "primary processing"; 2. The definition of "Primary Processing" refers to certain types of processing activities including to "liberate an Extractive Product from its natural state" – "Extractive Product" requires the product to be in the form in which it exists upon its recovery or severance from natural state. The use of the term "Primary Processing in conjunction with "from its natural state" and "Extractive Product" could be taken to imply a limitation to the definition, particularly when coupled with the use of words in that sentence which are largely descriptive of true "Primary Processing" – i.e., the first stage of processing of resource products. This could be interpreted as a limitation of the definition in conflict with the positive lists in sub-para (a) and (b). For the avoidance of doubt, alloying should be specifically mentioned in some way – see suggested drafting. 3. The current definition does not provide certainty in respect of alloys. Alloys are a metal made by combining two or more metallic elements, often to give greater strength or resistance to corrosion. Aluminium, platinum and copper are all examples of commodities which are technically an alloy due to the addition of other metallic elements to the underlying base commodity to result in a marketable commodity. Where specific products are not intended to benefit from the extractives exclusion, for example steel,	scope of the exclusion as expressed in 20.12 (a) and (b). The definition could then be drafted as follows: *"Eligible Processing" includes (but is not limited to) processing undertaken to concentrate, separate, reduce, isolate, purify, refine, smelt, blend, combine or liberate an Extractive Product or Intermediate Products derived from Extractive Products to produce a basic commodity or commodities, and includes carbon capture utilisation and storage conducted in connection with such processing. It includes processing undertaken to produce Intermediate Products derived from an Extractive Product. Intermediate Products include (but is not limited to) those listed on the Intermediate Products Schedule and includes the following:* *a. liquified natural gas (LNG), liquified petroleum gas (LPG), natural gas, crude oil, diesel, kerosene, gasoline, gas to liquids (GTL) products, hydrogen, and bitumen;* *b. Minerals, Mineraloids and metals including metal concentrate, metal oxides, metal powders, metal hydroxides, anodes, cathodes, cast metals, alloys and aluminium.* *Eligible Processing does not include the following:* *(a) a product resulting primarily from extrusion, fabrication or manufacturing or the creation of a consumer product; and*

Para	Topic	Issue	Recommendation
		we recommend that the negative list be used to achieve this. Alternatively, consideration could be given to a definition of "accepted alloys" or similar however we note that this is more likely to create uncertainty as compared with a clear list; 4. There is inconsistency with the inclusion of crude oil, but not natural gas within 12.1(a). We had assumed that crude oil and natural gas to be an Extractive Product. 5. Gas to Liquids (GTL) processing typically takes place in the country of extraction and is in line with the definition of Primary Processing. Some GTL products are mentioned in the Extractive Exclusion (e.g., Kerosene and gasoline) while others are not. 6. We note that Bitumen derived from processing oil sands, oil shale and heavy oil, have now been removed from the Extractives Exclusion – we believe this should be within the scope of the exclusion in line with the definition of the Primary Processing. •	(b) *the production of steel, jewellery, [petrochemicals, manufactured chemicals], plastics, plastic polymers, or similar products.* We will provide a suggested list of commodities for inclusion on the Intermediate Products Schedule.
20.1b	Extractives Group	What does 'have a substantial connection' mean, and what, if anything may be required to demonstrate the same Reference is made to a Group being a Qualifying Extractives Group where… "…it derives Extractives Revenues, which in aggregate have a substantial connection with its Exploration, Development or Extraction". Using only Extractives Revenues as the measure to determine whether a Group is a Qualifying Extractives Group is inappropriate. It may often be the case that Extractive Revenues do not form the larger part of the total group revenues for MNCs in the extractives sector. Consideration of	Commentary to provide guidance/clarity and that other relevant measures, qualitative and quantitative, can be used to demonstrate qualification of a Group as a Qualifying Extractives Group.

Para	Topic	Issue	Recommendation
		other relevant financial measures, e.g., profits, assets or other quantitative or qualitative measures relevant to the group should be made.	
20.14 and 20.15	Definition of Extractives Revenue and application of the ALP	As noted above, the definition of "Extractives Revenue" is important. 20.14 provides that "Extractives Revenue" means revenue of an Entity that is resident in the Jurisdiction of Extraction. We understand this is intended to stop the exclusion when the Extractives Product is transferred to another jurisdiction (e.g., bauxite is transferred from the country of extraction to another country for refining into alumina or crude oil transferred from country of extraction to another for refining). 20.14 refers to the application of the Arm's Length Principle (ALP) "as necessary". There are three circumstances in which the ALP will be relevant: 1. Where there is a transfer of the extractive material to another jurisdiction; 2. Where the backstop applies within an entity (which has an integrated supply chain); 3. Where the backstop applies to transactions between entities within the same jurisdiction. 20.15 then goes on to apply the Arm's Length Principle to determine the Extractives Revenue in respect of scenario 2 above – where an entity undertakes further processing which goes beyond "Primary Processing".	Extension of application of 20.15 to apply the Arm's Length Principle where an Extractive Product has been transferred from the Jurisdiction of Extraction to another Jurisdiction (e.g., for further processing) and where the backstop applies to transactions between entities. [ALP discussed further below]

Para	Topic	Issue	Recommendation
		Whilst 20.14 refers to "adjusted as necessary for the application of the Arm's Length Principle" it is not clear that it is requiring application of the ALP for scenarios 1 and 3 above.	
20.14	Extractives Revenue	Whilst "Extractive Activity" includes "Primary Processing" and "Qualifying Transportation", "Extractives Revenue" cuts off the revenue to that from the Jurisdiction of Extraction. For integrated Oil & Gas and Energy companies, "Extractive Activities" would normally include transporting products, from the jurisdiction of extraction to another jurisdiction for "Primary Processing" of the products. Therefore, the definition of Extractive Revenue and restriction to that from the Jurisdiction of Extraction is not consistent with the way integrated Oil and Gas multinationals operate and with the intent of the definitions on "Qualifying Transportation", "The sale of an extractive product" and "Primary Processing". 20.14 also references "associated hedging gain and losses" Note that these activities are typically carried out by the Trading arm of Oil & Gas multinationals on a global / portfolio basis rather than on a product-by-product basis. Trading is an integral part of getting our products to the market (transportation), in addition to hedging for the Extractives business. Given the integral functions of the Trading business, consistent with how Extractives Group operate (i.e., highly integrated), "Extractive Revenue" should be defined to remove reference to Jurisdiction of Extraction. Limiting the Extractive revenues to only revenues derived in the country of extraction, will require oil and gas companies to	Remove reference to Jurisdiction of Extraction from the definition of the "Extractive Revenue"

Para	Topic	Issue	Recommendation
		perform revenue/ profitability bifurcation within business segments that would generally be considered extractive in nature leading to additional administrative complexity.	
20.17	Definition of Arm's Length Principle (ALP)	As noted above, there are three circumstances in which the ALP will be relevant: 1. Where there is a transfer of the extractive material to another jurisdiction; 2. Where the backstop applies within an entity (which has an integrated supply chain); 3. Where the backstop applies to transactions between entities within the same jurisdiction. We accept that not all Inclusive Framework countries have adopted the OECD Transfer Pricing Guidelines. It may be the case that jurisdictions have adopted domestic transfer pricing rules based on the ALP, albeit they are not underpinned by the OECD TP Guidelines. Regardless, an ALP approach is most likely to be relevant in respect of scenario (1) above. In fewer cases there may be a domestic transfer pricing regime which will cater for scenario (3). There is unlikely to be any domestic transfer pricing regime to cater for an ALP approach in respect of scenario (2). The question is therefore what is the meaning of the term "Arm's Length Principle" for the purposes of Amount A. The current definition is "means the principle under which transactions between Group Entities must be recorded by reference to the conditions that would have been obtained between independent enterprises in comparable transactions and under comparable circumstances."	A common approach should be applied in respect of all 3 scenarios in which this is relevant under Amount A, particularly in respect of transactions within a particular jurisdiction. We recommend the following: -Where domestic transfer pricing legislation exists in the source country, which is based on the ALP, adopt the application of the ALP pursuant to that legislation in all three scenarios. For countries which follow the OECD Transfer Pricing Guidelines this would involve the application of Article 9(1) of the OECD Model Tax Convention (MTC) and the OECD Transfer Pricing Guidelines; -Where the source country does not have domestic transfer pricing legislation which is based on the ALP either: • Article 9(1) of the OECD MTC and articulated in the OECD Transfer Pricing Guidelines should be applied (in respect of all three scenarios); or • Article 9(1) of the UN MTC and articulated in the UN Transfer Pricing Manual should be applied (in respect of all three scenarios).

BUSINESS at OECD

Para	Topic	Issue	Recommendation
		Without further guidance we see significant scope for uncertainty and dispute in respect of the application of the ALP for the purposes of the extractive exclusion, in circumstances where its application is central to outcomes under the exclusion. What is also clear is that the application of different ALP approaches with respect to the three categories where the ALP is relevant as noted above (and in respect of the same jurisdiction) will create significant additional compliance, complexity and uncertainty.	
Section 20.14	Extractives Revenues	There is a requirement that revenue be 'reported in the financial accounts… clarity is required which accounts are referred to for the purpose of the various provisions e.g., group consolidated financial statements, stand-alone entity accounts for the purpose of the entity test etc. The use of branch structures is very common in the extractives sector. Is a branch an Entity for the purpose of determining Extractives Revenues? Whilst branch accounts will very likely be prepared, and the branch profits taxed in the country of extraction given it is resident there, a branch will not have statutory accounts.	Clarity required that it is the inclusion of the revenues in the UPE consolidated accounts by reference to the Entity (be that legal entity/branch/PE) which is relevant in determining Extractive Revenues. Definition of Entity in Article 10 of the substantive rules (Title 7 2) should be expanded to include a Permanent Establishment (Branch) In this regard, we note Schedule I contains the definition of "Entity Financial Accounting Profit (or Loss)" – may be useful here i.e., reference to "separate financial statements".
Section 20.14	Extractives Revenue	The 'and' at the end of para b may cause some confusion. We assume extractive revenue is revenue from any of paragraphs a, b or c.	Consider adding "from any of the following": ahead of paragraph a.
Section 21	Transition	21.1 refers to "Initial Transition Phase" however the definition included at 21.2 is of "Initial Extractives Transition Phase"	Use consistent terminology
21.1(a)	Transition	It would appear that for the transition phase it is intended that a simplified approach be applied which removes the cross-border	Extend the transition rule so that the removal of the cross-border restriction applies to both the non-Extractives revenue test (including when applying the

Para	Topic	Issue	Recommendation
		limitation from the definition of Extractives Revenue (at section 20.14). However, the drafting of this provision by reference to whether the Group meets the profitability tests but to then go on to refer to *"where a Disclosed Segment for which 75% or more of the revenues are… Extractives Revenues, irrespective of whether the revenues were reported in the Jurisdiction of Extraction, the segment may be treated as an Extractives Segment"* - this creates a cross concept that could be confusing. We assume the intention here is that the cross-border limitation is ignored for all purposes of the provisions during the transition period – including determination of extractive revenue (including for the purposes of the short cuts) and the for the profitability test.	shortcuts in section 2.5) and the non-Extractives profitability test. This would significantly reduce compliance during the transitional period. Our suggested modification is as follows: *"Notwithstanding the provisions of this Act or this Schedule B, during the Initial Transition Phase, a Qualifying Extractives Group may demonstrate that it does not meet the non-Extractives revenue test (including when applying the shortcuts in section 2.5), the non-Extractives segment revenue test, the non-Extractives profitability test or the non-Extractives segment profitability test (as applicable) in the Period by applying any of the following calculations:* *a. where a Disclosed Segment or Entity for which 75 percent or more of the revenues for a Period are revenues derived from activities listed under section 14 a, b and c, irrespective of whether these revenues were reported in the Jurisdiction of Extraction, the segment may be treated as an Extractives Segment".* We also recommend the same approach is available for MNE Groups adopting the Entity approach. The current drafting appears to be limited to the MNE Groups adopting segment approach. To reduce complexities of filings during the transitional period, we welcome the removal of cross-border restriction to both the Segment and Entity approach.
21.1(b)	Transition - Profitability	Subsection 21.1(b) provides that the "Pre-Tax Profit Margin of a Non-Extractives Segment or Mixed Segment" may be	Clarify the intended simplification that section 21.1(b) is intended to provide, noting the following:

Para	Topic	Issue	Recommendation
	Test – Profit Margin	determined using the Segment Pre-Tax Profit Margin as defined in Schedule D. The "Pre-Tax Profit Margin of a Non-Extractives Segment or Mixed Segment" is not defined in the rules (see also our comments above at section 6.5(a)) and it is unclear how this should ordinarily be calculated absent the transition rule. This definition is used in determining whether the non-Extractives profitability test is met using the Disclosed Segment Approach (at section 6.5). Without a definition, the "Segment Pre-Tax Profit Margin" definition in Schedule D is currently the most logical definition to use in determining the "Pre-Tax Profit Margin of a Non-Extractives Segment or Mixed Segment". Accordingly, if subsection 21.1(b) is meant to simplify the non-Extractives profitability test, the benefit/simplification that subsection 21.1(b) is intended to provide as a transition rule is not clear. We expect section 21.1(b) is actually intending to simplify the process of determining whether a Covered Segment meets the non-Extractives ***segment*** profitability test in section 11.3. In determining whether the non-Extractives segment profitability test is met at section 11.3 (when determining whether a Disclosed Segment of a Qualifying Extractives Group is a Covered Segment), this relies on the definition of "Non-Extractives Segment Pre-Tax Profit Margin" at section 19.6.	If subsection 21.1(b) is meant to simplify the calculation of "Pre-Tax Profit Margin of a Non-Extractives Segment" under the non-Extractives profitability test, then section 21.1(b) requires amendment to clarify what concession/simplification this transition rule is meant to provide (assuming the definition of "Segment Pre-Tax Profit Margin" in Schedule D should ordinarily be used to determine the "Pre-Tax Profit Margin of a Non-Extractives Segment"). If our understanding is correct that section 21.1(b) is actually intending to simplify the non-Extractives ***segment*** profitability test, we expect subsection 21.1(b) is meant to simplify the calculation of "Non-Extractives Segment Pre-Tax Profit Margin". Accordingly, our recommendation is to replace the reference to "Pre-Tax Profit Margin of a Non-Extractives Segment or Mixed Segment" with "Non-Extractives Segment Pre-Tax Profit Margin".

Para	Topic	Issue	Recommendation
		If subsection 21.1(b) is meant to simplify the non-Extractives segment profitability test, subsection 21.1(b) contains an incorrect reference to "Pre-Tax Profit Margin of a Non-Extractives Segment" which should be replaced with "Non-Extractives Segment Pre-Tax Profit Margin".	
21.1	Transition - Simplified Filing	MNE Extractive Groups would benefit from reduced disclosures and simplified filing during the transitional period.	An effective simplification would be to enable MNE Groups to rely on disclosures in the financial accounts for the transition period.
General	Mechanics of Calculation	Based on our worked examples the key element will be accounting for the elimination required for intragroup extractive transactions as outlined above. We have not identified any other material mechanical errors or concerns. The allocation of profit and elimination for double taxation for the extractives exclusion are yet to be drafted however we have tested these based on the general scope rules and didn't have anything particular to note.	To note only

4.5. Regulated financial service exclusion

Section	Topic	Issue	Recommendation
Background	Lack of consensus in the TFDE	From the insurance industry's perspective, it is a critical issue of tax certainty that the TFDE reaches an agreement on the exclusion of reinsurance from Amount A. Like insurance, reinsurance is subject to solvency and capital regulatory requirements, as well as prudential regulation. Reinsurance is insurance for insurers: reinsurance contracts are inextricably linked to the underlying insurance contract.	N/A

Section	Topic	Issue	Recommendation
General	The terms 'revenue' and 'income' appear to be used interchangeably	Financial statements for (re)insurance groups are very specific: using these terms interchangeably could cause confusion and add a layer of complexity for (re)insurers, due to their specific meaning in the (re)insurance sector. If the intention is to use both "revenue" and "income" to describe the same thing, then only one term could be used. If, however there is a deliberate reason why "revenue" is different to "income" then this should be clarified. An example of this is the definition of "total reported income" which equals revenue.	Clarify the definitions of 'revenue' and 'income' so they are not used interchangeably.
Schedule C - Calculation of non-RFS revenues	Treatment of funds	Clarification is needed as to whether funds which are consolidated in the Group's accounts can be ignored for the purposes of calculating non-RFS revenues, both in respect of dividend and FV movements under Articles 5(2)(b)-(c).	It would be helpful if this could be clarified in the commentary.
Schedule C, Section 2, Para 1	Group conducting RFS	In the insurance and reinsurance industry, there is a speciality tenet according to which an insurance company only writes policies under the class of insurance for which it has been granted a license. Therefore, insurance groups predominantly comprise RFIs as defined in the public consultation document. Where non-RFS activities are carried out, they are mostly ancillary services to the insurance or reinsurance activities of one or more Group Entities.	N/A
Schedule C, Section 20, Para 1, 6, 10,11 (c), 12	Definition of Insurance	In the public consultation document, only 3 types of insurance policies are defined: annuity contracts, insurance contracts and insurance products. However generic those definitions are, they are not sufficiently broad to encompass the variety of (re)insurance policies which insurers and reinsurers are licensed to write. Each	See comment under para 11 (c)

Section	Topic	Issue	Recommendation
		jurisdiction has its own market particularities and regulatory requirements. Furthermore, in today's rapidly changing world insurance and reinsurance are required to evolve and adapt. As new risks arise, new classes of (re)insurance appear that may not be covered by the current definition.	
Schedule C Section 20, para 4	Definition of Deposit	Definition requires principal to be repaid at par and this does not address the issue of deposits in accounts in another currency.	Definition should be amended as follows: • *"It does not include down-payments made by customers as part-payment of the purchase of a good; funds where the principal is not repayable at par (except for deposits made in local currency into an account of another currency where fluctuations in the par value are a result of currency fluctuations)"*
Schedule C, Section 20, para 10	Definition of Insurance Contract	(1) To reflect the exclusion of reinsurance from Amount A, reinsurance should be explicitly included to ensure a comprehensive definition (2) It is unclear why the definition refers to "*significant*" insurance risks and what level of risk is implied by the term "*significant*". Insurers and reinsurers write polices to address risks listed under the regulatory definition of the classes of (re)insurance which they are licensed to operate. Insurance risk exists in all cases, it is not a matter of level.	Rephrase as follows: *"Insurance Contract" means a contract under which the issuer accepts insurance or reinsurance risks from another party by agreeing to compensate that other party if a specified uncertain future event adversely affects that other party."*
Schedule C, Section 20, Para 11 (c)	Income criterion for Insurance Institutions	As noted in the issue description for para 1, 6, 10 11 (c), 12 above, there is a risk the definition of (Re)Insurance business is not sufficiently broad, resulting in some areas of business being excluded from the exclusion and thus unintentionally subject to Amount A.	To avoid a definition that would not cover all the insurance business as licensed under various forms and particularities across Inclusive Framework countries, the income criterion could refer to the income "*… arising from all policies written by the*

Section	Topic	Issue	Recommendation
			insurer or the reinsurer, pursuant to the license granted by their Regulator…"
Schedule C, Section 20, Para 11 (c)	Income criterion for Insurance Institutions	We understand this phrase "*including investment income from assets associated with such contracts*" as meaning all financial investments necessary to allow the insurer or reinsurer to cover all their insurance liabilities.	It would be helpful to have clarification and confirmation of this point in the Commentary.
Schedule C, Section 20, Para 12	Definition of Insurance Product	The definition of "insurance product" is potentially limiting as it references "a contract under which the issuer agrees to make one or more payments to another party on death or on other specified dates". It does not make any reference to events, which are also a key determining factor in triggering a payout under a (re)insurance contract, particularly in property and casualty (re)insurance.	Rephrase as follows: *""Insurance Product" means a contract under which the issuer agrees to make one or more payments to another party on death or on other specified dates or on the occurrence of a specified event…"*
Schedule C, Section 20, Para 13	Definition of Insurance Risk	The definition of Insurance Risk is not sufficiently broad and may lead to items being excluded from the exclusion and therefore subject to Amount A. In particular Financial Risks can be and are commonly insured, as seen during the 2008 Financial Crisis when the (re)insurance industry was massively adversely impacted by policies that (re)insured financial risk. The exclusion of Financial Risk should be removed from the wording.	Rephrase as follows: *""Insurance risk" means a risk associated to an insurance or reinsurance contract, transferred from the holder of a contract to the issuer of the contract."*
Schedule C Section 20, para 14	Definition of investment institution	The definition follows the three-part test of a) licensing, b) capital adequacy requirements and c) an activity test requiring 75% or more of the Group Entity's Total Reported Income come from listed activities.	While we believe that the listing of activities in Paragraph 14.c. is well and thoughtfully constructed, we would suggest that the listing should be subject to periodic review, both to include and exclude activities, to ensure that the list continues to

Section	Topic	Issue	Recommendation
			appropriately reflect developments in financial activities and instruments.
Schedule C, Section 20, para 16	Definition of Regulated Financial Institution for purposes of the exemption.	The test is done by each Group Entity. For large financial groups this generally has the effect of excluding the entire MNE if the largest entities are RFI's. For conglomerates with a financial services segment, this has the effect of excluding only those legal entities that are RFI's and requiring the extraction of small non-RFI entities in the consolidated segment RFI financials to be backed out and included with the rest of the conglomerate's businesses.	For the Finance exclusion, the test is done by Group Entity. We had requested an exclusion for a RFI Segment where all entities are included in the financials submitted to the regulators. This means we don't have to separate out small subsidiaries which are conducting ancillary business that we include in the RFI consolidated financials submitted to the regulators. We recommend including a definition of Regulated Financial Institution Segment and allowing the exclusion of the entire segment if the RFI Segment can meet an additional predominance test that would require 90% of the Total Reported Income of the Segment to the regulators be derived from RFI activities, as an alternative to the 75% entity by entity test.
Schedule C Section 20, para 18	Total Reported Income	We note the new concept introduced of Total Reported Income as defined in Schedule C Section 20, Paragraph 18. We believe that the approach is intended to be helpful as being a direct way of ascertaining the income of a Regulated Financial Institution for the purposes of the various income tests used in the exclusion.	In the context of banks and brokers, we welcome the steps taken, but would ask for further clarification of the manner of operation in the Commentary. We would be pleased to discuss this matter further with the Secretariat to better understand the intent and operation of the concept.
Schedule C, Section 20, Para 18	Impact of incoming Solvency II reporting on the financial statements of (re)insurance entities.	"Total Reported Income" which is defined as "*the revenue, as reported on the Entity's financial statements submitted to the relevant financial regulator*", does not account for incoming Solvency II reporting, where returns do not include a P&L or financial statements from which revenues can be identified for each entity. In addition, not all entities will submit Solvency II returns on a solus basis.	The wording should be amended to recognise the new reporting requirements for entities operating under Solvency II. Total Reported Income could be collected from entity financial statements or consolidated financial statements, as for other sectors under Pillar One.

Section	Topic	Issue	Recommendation
Schedule B vs C, para 21	Transitional Rule for RFI Exclusion	The Extractive Industry exclusion is given a soft landing for transitional relief presumably to allow time to have qualification issues resolved in the advance certainty process. No similar rule is provided for RFI's	The Regulated Financial Institution exemption should be granted the same soft landing transitional relief while confirmation of qualification is being resolved.
Schedule C, 2.5	Pre-Tax Margin/ Reorganizations	Look-back is only three years for RFS. Why is it different than other taxpayers?	The Regulated Financial Institution exemption should be granted the same look-back period.
Schedule C, 10. 2 & .5	Pre-Tax Margin Test	As Non-RFS Group Revenues include revenues received by an Entity from RFS in the Group, why shouldn't the denominator include such as well?	Since such revenues are included in the numerator, they should likewise be included in the denominator.

5. Comments on interactions with Pillar Two

Para	Topic	Issue	Recommendation
7.5	Definition of Group Entity	"Group Entity" means any Entity, other than an Excluded Entity, whose assets, liabilities, income, expenses and cash flows are included in the Consolidated Financial Statements of a UPE… In comparison, the Pillar 2 rules apply to Constituent Entities where per the Definition of Controlling Interest "the interest holder at a) is required to consolidate the assets, liabilities, income, expenses and cash flows of the Entity on a line-by-line basis."	Recommend that the definition of Group Entity is amended to align with Pillar 2 and specifically note the reference to consolidating assets, liabilities, income and expenses on a line-by-line basis. "Group Entity" means any Entity, other than an Excluded Entity, whose assets, liabilities, income, expenses and cash flows are included in the Consolidated Financial Statements **on a line-by-line basis** of a UPE…
Para 22 – definitions (Tax Expense)	Definition of "Tax Expense (or Tax Income)"	"Tax Expense (or Tax Income)" is defined to include income tax (expense or income) included in calculating the Financial Accounting Profit (or Loss) under an Acceptable Financial Accounting Standard. It also includes current and deferred income tax expense (or income) as recognised in the Financial Accounting Profit (or Loss). It is not clear whether these also includes any top-up taxes paid under Pillar Two.	We suggest clarifying whether Tax Expense (or Tax Income) covers any top-up taxes of the Covered Group under Pillar Two. That is, to the extent Pillar 2 is recorded in the P&L it should be excluded for the purposes of calculating P1 reallocation of profit.
n.a.	Pillar 1 & 2 interaction	MNEs will have a significant compliance burden that may become impossible depending on the interaction of the P1 and P2 rules. This could arise when an MNE is subject to an Amount A reallocation late in the reporting deadline cycle, while at the same time having to recalculate its P2 liabilities and compliance reporting. Depending on the timing and countries involved, there could be created significant complexity in respect to the quantum of adjustments and reliefs for both P1 and P2, and getting agreement of which country is relieving for such adjustments. How do MNEs and fiscal authorities keep track of such complexity to ensure disputes are minimised and the compliance efforts of MNEs is proportional.	The interaction of applying Pillar 1 and Pillar 2 should be clarified in the administrative guidance. Per the Pillar 2 commentary, Pillar 1 is applied first before Pillar 2 is applied. Consideration should be given to any complexities this could cause if there is a dispute over Pillar 1 allocations as it may create Pillar 2 disputes as well.

6. Appendix 1: Implementation suggestions for incorporating withholding taxes

The proposed approach described in Section 3.3 presumably creates the need to track the actual relieving country tax relief given, and one could imagine the audit trail back to the tax returns as filed. This raises the question as to whether the relief was obtained as a tax credit or an expensed item. A beneficial simplification for the relieving country would be to always treat this as a credit for purposes of Amount A. If it is a country that allows for unutilized WHT to be carried forward, logically the adjustment should be for the amount of the WHT actually used against the relieving country tax in the year. Again, the audit check would be to tax returns filed. Here, a beneficial simplification in general would be to always treat the level of in-year WHT suffered as credit for the purposes of Amount A such that complicated issues of whether there was a credit, cost deduction or none of aforementioned, as well as whether there is carry-forward or not, becomes irrelevant for Amount A purposes. The alternative of giving an adjustment for all WHT arising in the year, whether credited or not, could be described as a simplification but one can envisage the pushback from countries to support that in respect of income that is not actually sheltered by foreign tax relief.

7. Appendix 2: Modeling results

As discussed in our introductory letter, we believe that policy makers may be served by insights provided by the business community on impact of the model rules to in-scope MNEs with differing business models. This appendix serves to begin that engagement based on preliminary feed-back provided by several in-scope MNEs.

7.1. Centralized business model

7.1.1. Consistent profitability

This US MNE generally fits the following description:

- operates in what may be described as a highly centralized business model, with regionally based principles in the US and European/Asian investment hub countries that serve their respective regions;
- principally sells to various independent distributors but also sells directly to end consumers, both in the US and internationally;
- earns relatively consistent profit margins in excess of the threshold 10% return on sales in all of it key markets, both domestic and internationally;
- has a relatively limited local sales presence in more than 95% of its international markets and sources sale-based returns in those countries, with residual profits sourced and taxed in either the US or the regional investment hub countries.

Initial observations:

- In light of relatively consistent profit margins across its geographies, this company does not foresee an issue with the measurement of Amount A on a global basis to be applied uniformly in all market countries.
- It foresees relatively modest reductions in Amount A under the MDSH for its international markets, ranging from 5-15% depending upon the Y%. The MDSH reductions are not applied uniformly, as the MDSH reductions are observed to have a more pronounced impact in smaller market countries where it has a taxable presence but principally sells through third parties. The MDSH has a much less pronounced impact in larger markets where the MNE sells more directly to end consumers and thus has a larger local presence. It generally foresees that Amount A would be eliminated under the MDSH for its US market since all profits from US sales are already sourced and taxed in the US.
- The elimination of double taxation burden falls entirely on its investment hub countries, which is generally to be expected. Notably, absence of a nexus requirement means that the investment hub countries also bear the burden of elimination of double taxation for countries in the Americas, notwithstanding that sales to those countries are initiated from the US.

7.1.2. Varying profitability by region/country

This US MNE generally fits the following description:

- It operates in what may be described as a regionally managed business model, with headquarter locations in the US, China and "investment hub" countries based in Europe, Latin America and Asia that serve their respective regions. The management headcount and hierarchy are split approximately 50/50 between US and non-US locations. All global intellectual property rights are owned in the US.

- The regional management structure is driven by the economics of its supply chain (it is generally uneconomical to ship its goods beyond a 500-mile (800 Kilometer) radius and due to regional differences in pricing, cost, as well as consumer tastes.
- The company globally sells predominantly (+95%) through local related party distributors in approximately 80 countries with its remaining sales sold directly through independent distributors operating in approximately +100 countries where the company does not have a physical presence. Less than 1% of its global sales are sold directly to end consumers globally.
- This company consistently earns global profit margins in excess of the threshold 10% return on sales but has dramatic variation in profitability by region and country. The US is the largest and most profitable market, earning more than 100% higher profitability as a percentage of sales as compared to the average of the non-North America markets. Approximately 90% of what is sold in the US is manufactured, sold and consumed in the US market (with IP being owned in the US as well). As a result of these factors, a globally calculated amount A overstates the actual regionally calculated Amount A attributable to non-North America jurisdictions by approximately **250%.**
- On a global basis, manufacturing, distribution, and shared services functions receive a guaranteed routine return based on market comparables. The US and China are full entrepreneurs for their regions. The non-US management centers (including China) earn residual returns after paying royalties to the US determined under a residual profit split transfer pricing methodology supported by APAs with the US.

Initial observations:

- As noted, the globally calculated Amount A creates material distortions as compared to this company's actual regional supply chain profitability. The proposed MDSH is highly formulaic and produces differing results due to small changes in the allocation ratios. Even when assuming the most favorable assumptions that drive these financial ratios and yet to be finalized definitions, application of the MDSH to a globally calculated Amount A for this company still results in an allocation to market jurisdictions that is approximately 100% greater than a regionally calculated Amount A. This material distortion is a result of the use of global financial information as compared to the company's actual regional profitability outside of North America.
- MDSH is intended to limit double counting the allocation of excess returns to a market jurisdiction. The absence, as of yet, of an agreed Amount B based on the arms-length principle, however, substantially undermines the express purpose of the proposed MDSH. The proposed MDSH is formulaic and not grounded in traditional ALP measures for a distributor (Return on sales, return on **all** distributor operating costs – [Berry ratio], or even a share of profit based on stated maximum percentage of systems profits [20% - 25%]) nor does there appear to be any obvious direct linkage between Amount A and B.
- The final guidance for Pillar One should make it clear that the 10% operating profit threshold for calculating Amount A should not be viewed as informative on the determination of a distributor's routine return for the purpose of determining amount B. The 10% threshold for Amount A is intended to be a proxy for all global routine activities of an MNE group.

- The MDSH formulaic approach of establishing a "routine" return baseline based upon depreciation and payroll also appears to make arbitrary distinctions between leased assets and owned and depreciated assets. It is also worth noting that the approach of MDSH tends to favor larger and more developed markets as compared to smaller or less developed markets.
- Equally troubling, the unagreed inclusion of all WHT on deductible payments as a reduction to Amount A allocations further undermines the purpose of the MDSH. This is particularly true where the WHT are applied on a gross basis and the rate is material. In many circumstances, WHT on deductible payments represent an independent and material claim on a MNE's global excess returns. A properly designed MDSH would take these taxes into account in determining if the market jurisdiction is entitled to additional excess return allocations under Amount A. If WHT on deductible payments are not considered within the mechanics of Amount A, the political balance of Pillar One can be completely destabilized by market jurisdictions adopting new and novel WHTs.
- Lastly, the MDSH does achieve the objective of reducing the global quantum of allocated Amount A to a market jurisdiction, but it does not cure the inequity of a materially overstated global Amount A as described above and its effect of causing a surrender jurisdiction in one region to pay a portion of an overstated Amount A to markets in other regions where the surrendering entity has no direct business management or transactional connection.

7.2. Decentralized, local business model

Here we describe two non-US-headquartered MNEs that operate in decentralized business models.

7.2.1. Asset-intensive B2B business

The in-scope group has a highly local, decentralized structure where the subsidiaries are acting as entrepreneurs, producing and selling goods and services mostly in their market jurisdiction and retaining any residual profit (or loss) deriving from the business.

Intercompany transactions mostly consist of the license of the technology IP which is owned by the ultimate parent company and central management fees.

Initial observations:

- The application of the rules leads to significant Amount A allocations from market countries to other market countries, with no economic rationale
- The MDSH reduces a portion of the tentative Amount A to be allocated to the various jurisdictions but does not avoid Amount A allocations in major market countries of the group: the US and Germany, where the activity is highly local, nevertheless receive a significant share of Amount A. A residual Amount A is also allocated to many smaller jurisdictions which happen to have a lower profitability than the average returns of the group
- The threshold return on depreciation and payroll of the group is slightly lower than 40%. The use of 40% as the "higher" amount slightly reduces the effect of the MDSH for some countries (but the application of the actual threshold return would still lead to the same effect as described above)

- Relieving jurisdictions are notably China (by far the largest), Taiwan, Japan, South Korea, but also Russia and Argentina
- The jurisdiction of the parent company owning the IP is not a surrendering jurisdiction

The reason for the market-to-market allocations is the fact that the profitability and RODP are not homogenous in all countries where the entrepreneur subsidiaries operate.

For the purpose of the modelling, the group has assumed a Y% allocation offset of 100% and no de minimis rule for the MDSH. If Y was below 100% and there was a de minimis threshold, this would lead to even more market-to-market Amount A allocations.

7.2.2. Consumer-facing business

The company operates in a decentralised way and payroll costs are more relevant to its business than depreciation costs. Preliminary results of Pillar 1 modelling show that:

- Market countries pay market countries with two notable exceptions being a) an IP owner which does not have a big domestic market, and b) a group treasury company which has scale but doesn't need a lot of employees or tangible assets and is not located in a country with a big domestic market
- Headquarter countries are shielded to a certain extent by higher payroll expenses, and potentially also unrecovered centralized service costs
- Developed economies with lower profit margins are being subsidised by developing/emerging countries with higher profit margins. The assumption seems to have been made that the ratio of payroll expense to profits will not vary too much across countries, but that may not be the case for emerging economies where the country risk profile is higher and therefore the profit margins need to be higher to compensate for this risk.
- There are no entities in Tier 1 and all elimination is achieved in Tier 2
- Correctly adjusting for withholding tax - which has not resulted in actual tax being paid in the relieving jurisdiction- would likely remove the IP owner with a small domestic market from being a relieving country but probably not the group treasury company.

7.3. R&D-heavy business model

This non-US-headquartered MNE generally fits the following description:

- Operates in a high-cost and R&D-intensive field with a high level of uncertainty on the outcome of R&D;
- Has hubs owning IP and/or entrepreneurial functions in various jurisdictions;
- Operates in 100+ jurisdictions and sells mainly to the markets through related distributors and is subject to price regulations;
- Has not insignificant amounts of B2B operations with other groups operating in the same industry.

Initial observations:

- There are inconsistencies resulting from using the global formulaic approach for the MDSH and elimination. Specifically, significant investments hubs (IP owners bearing the brunt of the R&D costs and risks) are earning smaller returns than some market jurisdictions after reallocation of Amount A. This is due to the fact that while global amount A is artificially considering that the deemed excess portion of consolidated profits that is market connected is 25% over 10% (so that 75% over 10% is deemed remuneration of IP and entrepreneur roles), the country-by-country allocation of Amount A and the MDSH are based on different metrics that do not adequately take into consideration the limited investments and value creation in market countries. This distortion over-remunerates markets and under remunerates investment hubs, reducing their investment capabilities.

- MDSH fails to capture and compensate for pricing and profitability differences between jurisdictions even if reduces the overall amount A in a significant number of jurisdictions where the group operates, *depending upon the Y%*. By far the largest beneficiary of amount A is the US in a significant manner (50% of amount A).
- The elimination of double taxation burden falls on its investment and IP owner hub countries. The absence of a nexus requirement means that the eliminating countries also bear the burden of relieving for countries with which they have no or limited connection.

7.4. Conglomerate

This US multinational generally fits the following description:

- Conglomerate operates several businesses that are largely economically independent of each other, with wide fluctuations in margins. Some businesses sell directly to end-consumers (i.e., retail) and some sell to unrelated businesses (i.e., wholesale)
- Some businesses operate entirely within one country (home country, developed economy country or developing economy country). Some of these businesses outside the home country are joint ventures with third parties (including governments). The profitability of these businesses is highly dependent on local cost structure. In many cases the business, by definition, cannot have foreign sales (i.e., the service must be consumed locally), and the vast majority of costs are local.
- The remaining businesses are predominantly globally integrated and consist of a highly centralized business model, featuring licensing from the U.S. In some regions, or country clusters, there is centralized management overseeing sales, marketing and distribution activities.
- The centralized businesses earn relatively consistent profit margins in excess of the threshold 10% return on sales.
- The domestic autonomous businesses have historically generated operating margins that vary significantly from the centralized businesses, either as losses or low-profit margins, or higher margins than the centralized businesses.

Initial observations:

- Due to the varied profit (or loss) margins of domestic autonomous businesses, this company contemplates a significant, and arguably highly distortive, reallocation of profits from applying Amount A.
- The presence of domestic autonomous direct-to-consumer business in the same market generates a windfall reallocation of the centralized business' profits, especially where there is no or minimal profit generated from the domestic autonomous business.

- This is further compounded by the fact that many of the lower margin or loss making domestic autonomous businesses typically generate retail direct-to-consumer sales which enhances the profits allocated on a pure sales basis (as much of the centralized business is wholesale business to business activity).
- The MDSH has a minimal impact in reducing Amount A, depending on the Y%. The MDSH can also have a more significant impact where there happens to be a domestic autonomous business that is more labor and capital intensive in the same market as the profitable centralized businesses.
- The elimination of the double taxation burden is expected to fall entirely on the U.S., largely due to the absence of investment hubs or highly profitable entities with limited substance. This burden is compounded by the fact that there are also some highly profitable domestic autonomous businesses in the U.S.
- Excluding domestic autonomous businesses would ensure the likelihood of extreme distortions are minimized as a result of applying Amount A.

7.5. Impact of different ownership structure to identical supply chains

Pillar One, Amount A treats identical supply chains with varying ownership structures differently. For instance, in case of wholly owned supply chains, a smaller amount of Amount A may be allocated to a market than in case of supply chains that operate through unrelated local companies ("split supply chains"), even if the distribution of activities, revenues and profits across the countries involved is identical. This difference in treatment will result in economic distortions by creating tax and economic incentives for businesses to operate through related supply chains and/or to centralize their operations outside of market countries, so as to minimize the Amount A that would otherwise be allocated to a market jurisdiction. This issue is not unique to a particular type of business. A wide variety of businesses operate through split supply chains, with traditional franchise models perhaps being the most prominent. In these models the entrepreneurial profit with respect to the market is negotiated at arm's length between the MNE and the local entrepreneur. We do not believe that policymakers intend to create these distortions in tax treatment based solely on whether a supply chain is wholly owned or not and suggest below that the OECD in its continuing technical work examine mechanisms for eliminating them.

A key reason for the above difference in treatment is that the MDSH is more effective in wholly owned supply chains than for split supply chains. Below are two examples. In Example 1 an MNE operates through a wholly owned supply chain through an entity that earns an entrepreneurial return in the market, resulting in an Amount A that would be eliminated (or reduced) pursuant to the proposed MDSH (i.e., the residual profit is already taxed in market). Example 2 involves the same fact pattern as in Example 1 except that the business in the local market is independently owned, and thus unrelated to the parent entity. Example 2 results in a substantially more Amount A being allocated to the market, without taking into account the profit already in the market through the activities of the third-party local entrepreneur (which is an arm's length market-based transaction). The examples assume identical numbers, the only difference being the related/unrelated nature of the local entrepreneur. This disparity in treatment will make tax considerations a primary driver of business supply chain structuring decisions, contrary to sound tax policy.

We suggest that approaches be explored which take into account residual profits already in the market in the split supply chain model in order to eliminate these distortions. We propose that approaches be explored that would (a) define a level of local market activity in split supply chains that would justify a carve-out or credit for MNEs that operate in such a structure, and (b) be supported by reliable data to illustrate the fact that the local market in a particular split supply chain already taxes residual, non-routine returns. We understand that this issue affects many business models in different industries, and so deserves special attention.

Illustrative Examples

Core Facts:

ACo, established in Country A, owns the IP of a proprietary product. ACo produces that product in an unpackaged form. ACo is also responsible for global marketing of the product. It has, for example, entered into sponsorship agreements for global sporting events.

BCo, established in the Country B, is a distributor of ACo's product and is responsible for preparing, packaging, and distributing the product. BCo is the sole customer of ACo and exclusively sells the product to third party retailers who sell to consumers.

ACo and BCo have entered into a contract under which:

- BCo exclusively prepares, packages, and distributes a product under the A Group brand in the Country B market, through locally developed routes to market and conducting point of sale trade marketing and customer promotions;
- ACo supplies to BCo:
    - a proprietary product;
    - trademark protection;
    - quality control guidelines regarding the preparing and packaging of the product; and
    - marketing and global branding support.

Initial observations:

For the year under consideration, the relevant figures are as follows

	ACo	BCo
Revenue	750	3750
Profit	250	250
Profit margin (ROS)	33.33%	6.67%

All of BCo's revenues are derived from the Country B market.

In Example 1, where the results of A and B would be consolidated, the additional profit to be allocated to the eligible market country would be 31.[2]

In Example 2, where A and B would be unconsolidated and only A would be in scope, the profit to be allocated to the eligible market country would be 44.[3] As BCo's profit margin is below 10%, the profits of BCo will remain unaffected by Amount A even if its global sales are in excess of the revenue threshold for Amount A.

In both examples, 250 is already sourced and taxed in the market country, but differing facts concerning the extent of ownership of BCo will produce different levels of Amount A allocated to

[2] Amount is computed as 3,750 consolidated revenue x 25% x ((500/3,750)-10%).
[3] Amount is computed as 750 x 25% ((250/750)-10%).

the market country. In principle, business decisions concerning the level of ownership of local entrepreneurs serving customers in the market should not drive a distinction in the level of Amount A, where the facts and circumstances in the market country are otherwise identical.

7.6. Y% sensitivity analysis on the MDSH

The tables below show the percentage of system profits that a group would need to allocate to a market jurisdiction for that jurisdiction not to be allocated Amount A, varying based on Y%. For this illustration, we have assumed that the jurisdiction has depreciation and payroll expenses that align with the group average, and hence the routine return for the purposes of the MDSH would be a 3% and 10% return on revenue, respectively.

The two tables illustrate that the MDSH design is very unlikely to limit Amount A even in those circumstances where the share of systems profits sourced and taxed in the market country is in excess of 25%. Indeed, in many circumstances, particularly where the Y% is less than 100%, the share of systems profits would have to be significantly higher than 25% to eliminate Amount A. This appears to be inconsistent with the stated policy goal of the MDSH to limit Amount A where residual profits are already taxed in the market country.

Table: Percent of System Profit Necessary to Zero-Out Amount A

Group Profit Margin	Safe Harbor Deemed Return as % of Local Sales	Amount A%	Where Y%			
			100%	75%	50%	25%
15%	3%	1.3%	28%	31%	37%	52%
20%		2.5%	28%	32%	40%	65%
25%		3.8%	27%	32%	42%	72%
30%		5.0%	27%	32%	43%	77%

In this example, more than 25% of systems profits are required locally to turn off Amount A, even with Y% = 100%, and the figures increase significantly as the Y% is reduced.

Group Profit Margin	Safe Harbor Deemed Return as % of Local Sales	Amount A%	Where Y%			
			100%	75%	50%	25%
15%	10%	1.3%	75%	78%	83%	100%
20%		2.5%	63%	67%	75%	100%
25%		3.8%	55%	60%	70%	100%
30%		5.0%	50%	56%	67%	100%