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To: Tax Treaties, Transfer Pricing and Financial Transactions Division OECD/CTPA

EBIT Response to OECD on Pillar One - Amount: A Draft Model Rules for Tax Base Determinations

Brussels, 4 March 2022

Dear Achim,

EBIT's Members¹ thank the OECD for the opportunity to provide comments on the OECD's public consultation document: Pillar One – Amount A: Draft Model Rules for Tax Base Determinations - 18 February 2022 – 4 March 2022. Below are a number of issues and open questions that EBIT believes are important for the OECD to take into account. At the same time, we regret the very short timeframe allowed under the public consultation for sending in comments.

Given the urgency and short time frame, EBIT are raising their issues and concerns with the tax base determinations rules in a summarized bullet point format, keeping it relatively short. At the same time, we do wish to emphasize that the listed issues and concerns in this document are not exhaustive.

I. General comments

- Whilst EBIT has some understanding for the current piecemeal release and the OECD has turned out no less than 13 specific Amount A model rules because of the highly ambitious timeframe, EBIT regrets that no opportunity appears to be foreseen for a public consultation on an OECD analysis of the interdependence between all the different sub-sets of rules and the comprehensive set of Amount A rules. The result of an analysis of a rule when viewed in isolation or when viewed as part of the comprehensive set of rules can be quite different. EBIT therefore strongly recommends the OECD to hold a public consultation on its analysis of the interdependence between all the different sub-sets of rules and the resultant comprehensive set of Amount A rules.
- As to the current Public Consultation Document, the document reveals that next to the already existing accounts to be drafted for regulatory and tax purposes yet another different set of accounts needs to be prepared. For (non-exhaustive) illustration, groups in scope of Amount A will need to draw up:
 - consolidated financial statements;
 - local financial statements;
 - local tax accounts or adjustments to financial statements for local tax purposes;
 - Pillar Two adjusted consolidated financial statements;
 - Amount A adjusted consolidated financial statements;
 - other regulatory recording requirements which may differ per industry and country;
 - ...
- The Public Consultation Document indicates that the adjustments for purposes of Amount A will be kept to a minimum in order to limit complexity and align where possible with adjustments under Pillar Two. EBIT's Members welcome this statement in the introduction of the Public Consultation Document. At the same time the specific adjustments for purposes of Amount A and the divergence with Pillar Two rules add to the complexity of the exercise and require substantial resources for a result that all in all can prove to be minimal. Differences between Amount A and Pillar Two can be

¹ EBIT's Members include Airbus Group, BP, Carlyle, Caterpillar, Diageo, GSK, Huawei, International Paper, Johnson & Johnson, JTI, Naspers, PepsiCo, Pfizer, Procter & Gamble, Raytheon Technologies Corp., RELX, Schroders, SHV Group and Vattenfall. For more information on EBIT see: www.ebit-businessstax.com

found, for example, at the level of pensions, foreign exchange and loss carry forward. EBIT's Members believe that the rules are complex and will create significant difficulties in terms of compliance, administrability and application for both MNEs and tax authorities. We consider that the tax base determination rules require further simplification and clarification.

- EBIT's Members understand that the document is written in an attempt to approximate the format of a legislative text. In consideration of the Public Consultation Document that was released for Amount A, it should be considered for ease of the reader and to allow for better understanding of the material to include the definitions and footnoted descriptions within the body of the text. As the document makes reference to topics in the body of the text and cross references to definitions and footnotes to support the topics, the process of reviewing the cross-referenced material causes complexity in fully understanding the topic in the body of the text and dilutes the power of a potential common legislative text. The Public Consultation Document should be written in a way that the body of the text is supported by the definitions, footnotes and examples in one integrated flowing discussion.
- The Public Consultation Document contains multiple references to the Commentaries that will elaborate on or clarify the application of the allocation rules or provisions. As such, EBIT's Members are convinced that these elaborations or clarifications form a substantial part of the Amount A tax base determination and should also be open for comment.

II. Comments on the Determination of the Adjusted Profit Before Tax of a Covered Group

II.1 Policy Disallowed Expense

- The definition of "Policy Disallowed Expenses" as noted in the model rules is: expenses included in calculating the Financial Accounting Profit (or Loss) of a Covered Group under a Qualifying Financial Accounting Standard for illegal payments, including bribes and kickbacks; and fines or penalties, whether or not periodic. This definition is similar but not identical to the definition provided under Pillar Two being: expenses accrued by the Constituent Entity for illegal payments, including bribes and kickbacks; and expenses accrued by the Constituent Entity for fines and penalties that equal or exceed EUR 50,000 (or an equivalent in the functional currency in which the Constituent Entity's Financial Accounting Net Income or Loss was calculated). The differences in definitions between Pillar One and Pillar Two can lead to inconsistencies between the application of the "Policy of Disallowed Expenses" as a result of the definitions not being the same. It is important to note the inconsistency in Pillar Two having a threshold application of Eur 50,000 for "fines and penalties" while Pillar One does not apply a threshold. Additionally, the term fines and penalties is a broad term that can cover different types of fines or penalties, such as fines or penalties applied by government organisations as compared to fines or penalties applied by other businesses (fines or penalties on late payments). The definition should clarify at what level fines or penalties should be considered. It is recommended that only fines or penalties applied by government organisations should be considered in the application of the "Policy Disallowed Expenses."

II.2 Subsidiary Shares

- The model rules don't clearly differentiate between the inclusion of a 100% owned subsidiary and the inclusion of a subsidiary in a controlled group with less than 100% ownership interest. The rules as currently written require a Covered Group to include 100% of profits of a consolidated subsidiary even when the covered group ownership of a subsidiary is less than 100%. The inclusion of 100% of a subsidiary's profits that is not 100% owned by the Covered Group, means that the Covered Group will be paying tax on a portion of profit that doesn't belong to the Covered Group. The model rules should provide for an adjustment to the profits of a subsidiary in a Covered Group that is not 100% owned by the Covered Group, to represent the true value of the subsidiary inclusion in the Covered Group.

II.3 Restatement Adjustments

- The model rules of “Restatement Adjustments” are not clear and contain burdensome compliance requirements for companies to manage 1) meeting the criteria of an “Eligible Restatement” and 2) the application of restatement limitations.
 - In applying a limitation on the “Eligible Restatement Adjustment,” companies are now required to track the adjustments in a similar way to other attributes (Operating Losses, Credit Carryforwards, etc). The restatement adjustments should be unlimited to eliminate the need for additional tracking of adjustments. Additionally, as Covered Groups make adjustments in accordance with IFRS or other acceptable accounting standards that are subject to audit, the timing of relevant adjustments is dependent on the application of new accounting standards. The adjustments of a company are done to provide the correct financial reporting information under law and not done in a manner that provides the best results for a company during a certain time frame.
 - As companies can move in and out of scope for Amount A, the requirements under the “Restatement Adjustment” rules are presented in a way that companies will need to constantly continue to monitor restatements once moving out of Amount A or even before moving into Amount A. The monitoring of adjustments will add additional complexities and cost to companies.
- The definition of “restatement adjustments” should be further clarified to exclude the limitation cap on adjustments and provide consideration for the companies’ position within the scope of Amount A.

II.4 Joint Ventures

- The definition of “Joint Ventures” as noted in the model rules shows a difference in the treatment for Joint Ventures as compared to other ownership interests. The difference in treatments should be removed or a detailed explanation should be provided for the differences.
- As Pillar Two has a more extensive definition of what a Joint Venture is and what requirements are needed to meet the criteria of a Joint Venture, it is recommended that a more extensive definition be applied to Joint Ventures under Pillar One. It is important to keep definitions aligned between Pillar One and Two to eliminate confusion and complexity when applying the model rules.

II.5 Impairment

- The model rules don’t specifically mention impairment testing, but the notion should be considered as it can be an impactful adjustment for large companies. The Pillar Two model rules include section 3.2.5 which discusses impairment accounting on the impact of GloBE Income or Loss. In relation to Pillar One, alignment should be made between the treatment of impairment accounting between Pillar One and Two to keep the model rules consistent and to eliminate the cost and complexity of having different considerations under the model rules.

II.6 Averaging Mechanism

- The model rules include a footnote number “5” which makes reference to *averaging mechanisms* but this is not further defined. Will averaging mechanisms be a mechanical approach to limit the applicability of net losses under Amount A, such as limiting the losses to a 5-year average of losses. Additional clarification is requested on the meaning of *averaging mechanisms*.

II.7 Losses

- Footnote 17 indicates that the introduction of time limitations to loss carry-forward is still under discussion within the TFDE. EBIT’s Members opine that adding different rules for loss carry-

forward will add another layer of complexity to the system. Further, we consider that no time limitations for purposes of tax base determination of Amount A should be included.

- Footnote 23 seems to cap the amount of transferred losses from the predecessor group to the successor group based on net asset value as a proxy. EBIT's Members suggest that the amount of transferred losses is determined on a case by case basis. This does not exclude the use of net asset value as an allocation key but leaves room for other - and at times - more appropriate allocation keys.

II.9 Capital gains

- The Public Consultation Document notices a difference in treatment in the rules on disposal of assets (included in tax base) where disposal of equity interest is excluded from the tax base. Although we notice this asymmetry in treatment, EBIT suggests to remove the distorting effect of such one-off items for Amount A purposes. Additionally, this alignment of the positions will help alleviate the compliance burden in making adjustments for equity gain and losses as compared to the disposal of assets.

III. Other

- The model rules have not made any mention of deferred tax adjustments or the impact of deferred tax adjustments on determining Amount A. The scope of the model rules should provide clarity on the inclusion or exclusion of deferred tax adjustments in consideration of Amount A.

IV. Overall Conclusions

- The Amount A: Draft Model Rules for Tax Base Determinations are very complex and will lead to uncertainty, and confusion when different companies / countries apply the rules differently.
- The administrative compliance burden of these proposals for MNEs and tax authorities must not be underestimated and should be reduced where possible.
- The absence of a comprehensive much progressed draft document including a full explanation and examples of the tax base determinations rules, as well as the absence of consensus, increases the difficulty of commenting on these rules.

EBIT's Members hope these comments are taken into account by the OECD. We are always keen to engage in further discussion and public consultations that will be required if matters are to be implemented successfully.

Yours sincerely,

European Business Initiative on Taxation – March 2022

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