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Organisation for Economic Co-operation and Development
Centre for Tax Policy and Administration
Tax Treaties, Transfer Pricing and Financial Transactions Division

Sent via email: tfde@oecd.org

Subject: Comments on OECD Public Consultation Document – *Progress Report on Amount A of Pillar One*

Ladies and Gentlemen:

We appreciate the opportunity to submit these comments on behalf of EY on the OECD's public consultation document, *Progress Report on Amount A of Pillar One* (the Consultation Document), and to engage with the OECD on this important topic.

The more comprehensive nature of the Consultation Document provides an opportunity for stakeholders to review how significant parts of the mechanics of the Amount A design are intended to work together and provide feedback on the practical implications. However, it is clear that substantial additional work is to be done by the Inclusive Framework to further refine and fill in these mechanics and to resolve differences in views. In light of the complexity of the proposed mechanics and the fact that the outcomes in particular situations are not intuitive, we believe it is essential that the Inclusive Framework provide an opportunity for additional public consultation with stakeholders on Pillar One Amount A following such further development and before work begins on translating the mechanics into provisions for the Pillar One Multilateral Convention.

Overall Comments

Pillar One is intended to fundamentally reform the international tax rules by changing how taxing rights over global business income are shared among jurisdictions. The new nexus and profit allocation rules being developed under Pillar One are intended to assign taxing rights to market jurisdictions regardless of whether the business has physical presence in such jurisdictions. One of the stated objectives of the work on Pillar One is to fend off the rise of uncoordinated unilateral taxing measures such as digital services taxes that are being put in place in jurisdictions around the world. Another benefit that has

been attributed to the Pillar One effort is reduction of the uncertainty created by the global growth in transfer pricing disputes. Ultimately, Pillar One has been described as necessary to the stabilization of the international tax system and the protection of economic growth. As the technical work on the Pillar One rules continues, we believe it is essential that policymakers keep a close focus on the implications that the design choices being negotiated have for these broad policy objectives.

We are concerned that the design currently reflected in the Consultation Document would not further these important objectives. Working through the complex mechanics for Pillar One that have been specified to date, it becomes clear that the overall result would be that a relatively small number of mature market jurisdictions would gain additional taxing rights, with the bulk of jurisdictions around the world likely receiving little benefit or seeing a reduction in their taxing rights. This outcome is largely due to the heavy reliance on Return on Depreciation and Payroll, coupled with the high percentage return used as a threshold, in the formula for the reduction in the Amount A allocation to a jurisdiction under the Marketing and Distribution Profits Safe Harbor and the formula for the obligation to surrender taxing rights to offset the Amount A allocations to other jurisdictions under the Elimination of Double Taxation rules. If the benefits of Pillar One are concentrated only in a small number of jurisdictions, those jurisdictions that do not benefit would have renewed incentives to pursue uncoordinated unilateral measures and take aggressive positions with respect to transfer pricing matters. The result would be further destabilization of the international tax system to the detriment of the global economy.

The formulas laid out in the Consultation Document are extraordinarily complex. Any change in a parameter would have effects that cascade through the formulas and potential impacts that would not be immediately intuitive. As the Inclusive Framework continues its work on refining the mechanics that have been set out in the Consultation Document as well as filling in the mechanics that have not yet been specified, we urge policymakers to thoroughly think through all the implications of each decision. Compromises made in negotiations that may be driven by individual sovereign self-interest must be carefully evaluated to ensure the outcome properly advances the shared objective of stability of the global tax system and sustainable economic growth.

Detailed Comments

Digital services taxes and relevant similar unilateral measures

A core objective of Pillar One is to prevent the spread of uncoordinated unilateral measures such as digital services taxes (DSTs) that unchecked would give rise to significant risk of overlapping taxation creating a barrier to cross-border economic activity. We believe that the October 2021 agreement both to withdraw existing unilateral measures and to not newly enact any such measures is a central element of governments' commitments to Pillar One. The implementation of these commitments is vital to achieving a comprehensive solution to the tax challenges arising from the digitalization of the economy that is principles-based and avoids double taxation.

The Consultation Document includes a brief paragraph describing how the Pillar One Multilateral Convention (MLC) is expected to address these commitments with respect to DSTs and relevant similar unilateral measures. However, the approach described deviates significantly from the governments' commitments reflected in the October 2021 agreement, creates ambiguity, and raises critical questions.

In particular, the Consultation Document indicates that the MLC will include a commitment not to enact DSTs or relevant similar measures that meet three general criteria. Moreover, it indicates that this commitment does not extend to four categories of measures. We are concerned that the introduction of these new conditions would inappropriately restrict the commitments that have been made and would leave room for future DSTs and other unilateral measures that are inconsistent with the objectives of Pillar One, would create significant distortions, and would result in a considerable economic and compliance burden. We urge the Inclusive Framework to ensure that the requirement not to enact DSTs or other unilateral measures is both clear and broad enough to achieve the objectives of Pillar One.

While the Consultation Document does not reference these conditions in connection with the commitment to withdraw all existing DSTs and relevant similar measures with respect to all companies, it does indicate that the MLC will include "a definitive list of these existing measures." Given the importance of these withdrawal commitments, we encourage the Inclusive Framework to release this list as soon as possible and to provide an opportunity for stakeholders to submit comments identifying any existing measures not included on the list that should be added to it. In this regard, we would note that the list should include measures imposed at the subnational level.

The Consultation Document also notes that further work will be done to develop the definition of DSTs and relevant similar measures and "to provide for the elimination of Amount A allocations" for jurisdictions that impose future measures that are in scope of these commitments. Given that the commitments in the October 2021 agreement cover DSTs and other unilateral measures as applied to all companies, we are concerned that a sanction for a jurisdiction's failure to meet its commitment that is tied to Amount A allocations would not be effective in ensuring that the commitments are met as to all companies, including those that are not within scope of Amount A. We urge the Inclusive Framework to continue to work to ensure that these commitments are honored in full. The likelihood noted above that only a relatively small number of jurisdictions would benefit from Amount A allocations under the currently proposed mechanics further heightens this concern.

Finally, we encourage the Inclusive Framework to develop a clear set of guidelines on the features that would cause a tax rule to be considered an inconsistent unilateral measure so that existing and future measures can be tested against those features to determine whether they are prohibited measures that fall within the commitments reflected in the October 2021. It is essential that stakeholders be provided an opportunity to comment on the guidelines on such features in draft form and such guidelines must be assessed in the context of the overall objectives of the Pillar One package.

Title 1 – Scope (including Schedules A through D)

General Scope and Schedule A

We encourage the Inclusive Framework to give further consideration to the following points related to the general rules on the scope of Amount A.

- Anti-fragmentation rules

We believe that a principal purpose test is an inappropriate tool for determining whether a group is a fragmented group, as it inherently would lead to uncertainty and potential controversy. Consideration should be given to developing a test that is more objective (e.g., whether the sub-groups were part of the same consolidated group for a specified number of years prior to the so-called fragmentation). Moreover, the prior consultation document covering scope indicated that examples and guidance would be developed on the facts and circumstances that would be relevant in making a determination regarding whether a group is a fragmented group. Clear guidance and illustrative examples are needed so that taxpayers and tax administrations have a common understanding of when the anti-fragmentation rules are to apply.

- Requirement to produce consolidated financial statements

We would like to reiterate that a requirement for a group that is not otherwise required to prepare consolidated financial statements to prepare such statements for the current period and the four preceding periods if the group would meet the revenue and profitability tests for such periods would be a disproportionate burden for affected taxpayers. Schedule A includes a reference to an opportunity for the taxpayer to file a request under an early certainty process, but it does not further elaborate. We encourage the Inclusive Framework to develop a process that could be used to make a determination whether such a group is likely to meet the thresholds to fall within scope of Amount A before any requirement to produce multiple years of consolidated financial statements is imposed on the group. In this regard, we note the reference in the prior consultation document on scope to the need for refinements in this area to ensure that a disproportionate administrative burden is not imposed on these groups, including the potential introduction of a materiality threshold in this area.

- Group merger and demerger rules

Further explanation regarding the concepts of “Group Merger” and “Group Demerger” would be very useful, including illustrations of the types of transactions that would fall within these terms for purposes of Amount A. In addition, any difference in meaning of these terms for purposes of Amount A of Pillar One and the same terms for purposes of Pillar Two should be made clear to avoid confusion.

Extractives and Schedule B

We welcome the simplification of the Extractives Exclusion that is reflected in the Consultation Document and the application of the exclusion through Primary Processing. We also welcome the flexibility to apply the exclusion on a segment or entity basis.

We note that the revised definition in the Consultation Document does not apply to commoditized petrochemicals, while it does include a limited number of low-margin refined products and activities (e.g., diesel, kerosene, metal concentrate, metal oxides, metal hydroxides, anodes, cathodes, cast metals and aluminum). Commoditized petrochemicals are comparable to refined products – they are simply a result of the conversion (i.e., Primary Processing) of base hydrocarbons (crude or gas) and are distinct from consumer products/specialized chemicals that require advanced value-added processing. There does not appear to be a clear policy rationale for differentiating between refined products and commoditized petrochemicals and we believe the Extractives Exclusion appropriately should cover both. We encourage the Inclusive Framework to consider deleting “petrochemicals” from

the exclusion from Primary Processing and specifically including aromatics and crude oil, naphtha and ethane crackers in the Primary Processing definition (Section 20, Paragraph 12 of Schedule B).

In Section 20, Paragraph 14 of Schedule B, the definition of “Extractives Revenue” seems to imply that only extractives revenue from the jurisdiction of extraction should be considered. Commodities (whether oil, gas or metals) are often transported across borders for further processing. This approach would require a split (at arm’s length) if an excluded product is sold to a separate entity, across a border (e.g., if naphtha is produced by a refining entity in Jurisdiction A and then transferred to a cracker within a different entity in Jurisdiction B). Further, the “entity” constraint would not seem to apply if an extractives jurisdiction entity directly owns (i.e., in branch form) the Primary Processing operations offshore. This is at odds with commercial reality, and the Extractives Revenues definition does not tie to the Qualifying Extractives Group definition (Section 20, Paragraph 1) which requires merely a “substantial connection” to Exploration, Development or Extraction undertaken by the Group. The policy basis for this requirement in the Extractives Revenue definition is unclear, and it would require burdensome administration to track and apply an index price to intra-group pricing. We recommend deleting the qualifier “of an Entity that is resident in the Jurisdiction of Extraction” from the Extractives Revenue definition (Section 20, Paragraph 14) and the associated definition “Jurisdiction of Extraction”.

With respect to Schedule B, Section 2, Paragraph 3(b)(ii) (scope average profit test) and its application to non-Extractives profit of Groups with a substantial level of vertically integrated extractive activity, we recommend that the average scope test for volatile “downstream” segments (once in scope) be retained, in order to prevent segments from frequently falling into and out of scope. We recommend that the text “where the Group was not a Covered Group in the two consecutive Periods immediately preceding the Period” be deleted. In addition, we recommend making clear that segmentation is only applicable at the UPE level (and does not apply to a reported segment of subsidiary that is not reported on the consolidated financial statements).

Regulated Financial Services and Schedule C

- Scope

We note that the description of Regulated Financial Services (“RFS”) revenue that reduces consolidated revenue for purposes of testing the €20 billion threshold in the Consultation Document has been changed from “third party revenue” in the prior consultation document on RFS to “the revenues included in the Consolidated Financial Statements that are earned by one or more Regulated Financial Institutions.” A statement in the commentary making clear that this language identifies the appropriate RFS revenue would be helpful.

- Definitions

We recommend establishing a process to facilitate periodic review of the licensing requirements and activities listed in order to ensure these descriptions appropriately reflect developments in financial activities and instruments (e.g., the addition of digital currency as a financial asset). Additionally, we recommend incorporating the information in the footnotes in the prior consultation document into the commentary to the rules in order to provide additional clarity on the licensing requirements and activities and the application and implementation of these rules.

- Specific RFIs

We welcome the changes to the definition of regulated financial institution ("RFI") Service Entity reflected in the Consultation Document allowing an entity that is less than wholly owned to qualify. We recommend incorporating footnote 23 from the prior consultation document into the commentary to the rules to provide additional context on administrative support services that are necessary to an RFI's business.

We welcome the addition of "Credit Institutions" to the RFS exclusion and the acknowledgement that certain regulated entities engaged in lending activities do not operate as deposit-accepting banks. In line with this principle, we suggest revising condition 'b' to require an entity "that is subject to capital adequacy requirements incorporating a risk-based measure" in order to distinguish between a bank institution that takes deposits and a non-depositary Credit Institution that engages in the same lending activities as a bank but that is not necessarily subject to the Core Principles for Effective Banking Supervision as provided by the Basel Committee on Banking Supervision as a result of their distinct business model and risk profile.

While the Consultation Document includes welcome refinements to the definition of Insurance Institutions, further clarifications are needed on the treatment of investments that support insurance-related liabilities that are not held directly by the regulated Insurance Institution. It is often the case that entities controlled by regulated Insurance Institutions manage the assets that support the insurance contacts of the regulated Insurance Institution and are tied to the reserves that the Insurance Institution is required to hold and that the entirety of the insurance business is subject to risk-based solvency requirements imposed by the insurance regulator. There appears to be a disconnect between the revenues that support insurance liabilities of the insurance entity and the revenue that can be treated as RFS revenue when testing against the €20 billion threshold. This could be resolved by linking the income of the controlled entities of the of the Insurance Institutions to the revenue that qualifies as RFS Revenue by clarifying that investment income arising from the assets that support Insurance and Annuity Contracts and Insurance Products is substantively RFS revenue of the insurance entity.

Covered Segment and Schedule D

It is important to recognize that application of Amount A on the basis of a Covered Segment would necessarily involve additional administrative burden for a taxpayer beyond what is involved in applying Amount A to a company as a whole, where complete and fully audited financial statements for the entire group that can be used as the basis for required calculations. We believe that the additional administrative effort required for application of Amount A on a segment basis should be kept to a minimum. This could be done by allowing taxpayers to use the segmented data that they prepare for financial statement purposes also for Amount A purposes without requiring significant adaptation, including using any additional information related to the disclosed segment that is prepared for management and other purposes in accordance with the relevant accounting principles to the extent needed for the Amount A calculations with respect to such segment. Moreover, we believe that use of

available tax certainty processes with respect to segmentation determinations should be at the discretion of the taxpayer and should not be mandatory.

We also are concerned that use of revenues as the sole allocation factor with respect to a Covered Segment may not appropriately fit the characteristics of all businesses and thus could lead to inappropriate results. Taxpayers should have the opportunity to apply an allocation factor different from revenues if this best fits their business. We therefore believe that the strict conditions set forth in schedule D, Section 5, Paragraph 6 for use of an alternative allocation factor should be eliminated. Moreover, the use of an alternative allocation factor should not be subject to a mandatory certainty process; rather, taxpayers should have discretion regarding the use of such processes or not.

Title 2 - Charge to tax

The Consultation Document describes Article 2 as containing the charging provision allowing a market jurisdiction to tax one or more Group Entities of a Covered Group. We urge the Inclusive Framework to clarify which entities would be considered taxpayers for the tax on Amount A Profit (i.e., would it be the Group Entities in the market jurisdiction or the Group Entities in Relieving Jurisdictions that eliminate double taxation with respect to Amount A Profit under Title 5 through a concept akin to permanent establishment). We also encourage the Inclusive Framework to clarify whether the Amount A Profit allocated to a jurisdiction under Title 5 would be offset by losses in that jurisdiction.

We further urge the Inclusive Framework to clarify how the Amount A Profit and associated tax would be treated for Pillar Two calculation purposes. This includes how Amount A Profit would be reflected for purposes of determining GloBE Income/Loss in market jurisdictions and Relieving Jurisdictions. Similarly, it includes how taxes on Amount A Profit would be treated for purposes of determining the amount of Covered Taxes in market jurisdictions and Relieving Jurisdictions.

Finally, in addition to stating that taxes on Amount A Profit would not affect any other direct or indirect tax, customs duty or social security contribution, Article 2 should also specify that tax authorities are not to use information collected through the Amount A process for other purposes including as the basis for any additional income tax adjustments that are not related to the Amount A process.

Title 3 – Nexus and revenue sourcing rules (including Schedule E)

We appreciate the work that the Inclusive Framework has put into further developing and considering the rules related to Title 3. However, there are many aspects of this Title that would be very difficult for taxpayers to implement. Our comments focus on these challenges and include some suggestions as to how the sourcing guidance could better align with the data and information limitations that businesses typically face.

One of our primary observations is that while the prior consultation document on nexus and revenue sourcing released in February 2022 discussed sourcing “transaction-by-transaction,” and that language related to sourcing by transaction has been omitted in this Consultation Document, in practical terms the sourcing requirements seem largely unchanged. Much of the sourcing guidance in Schedule E would

require transactional analysis. Likewise, the language in Article 4 that revenues "must be sourced in a manner that accounts for differences amongst 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," suggests a need to trace and understand transactional detail. While the explicit transaction language has been removed, what remains would seem to still require taxpayers to undertake a transaction-by-transaction review of their revenues.

Also, the Consultation Document expands on the brief reference to an "internal control framework" contained in the prior consultation document. Reliance on internal controls would create a substantial burden for companies to track to a level of granularity that their systems currently do not produce, as would be the case with a number of the indicators discussed in the Consultation Document. If the Inclusive Framework deems internal control systems necessary for Amount A purposes, we urge that sufficient time be provided for companies impacted by Pillar One to implement such systems before any reporting is required (the Initial Transition Phase will be helpful, but we believe it should be expanded – see our comments below). Also, we urge that expectations around the rigor of such systems be balanced with the materiality of the different types of revenues that a company may have (for example, a company should be able to utilize different standards of rigor for a system covering 80% of its revenue, versus one covering 20%).

We welcome the changes to the rules which allow companies to choose an "Alternative Reliable Indicator" when the use of a "Enumerated Reliable Indictor" or "Another Reliable Indicator" do not seem feasible. Given the amount of data that taxpayers would need to access in order to apply Enumerated Reliable Indicators or Another Reliable Indicator, and the strict requirements for use of those indicators, there is a high likelihood that taxpayers would need to rely on Alternative Reliable Indicators (or Allocation Keys, if no reliable Indicators can be identified). We suggest that the use of the Advance Certainty Review for any Indicator should be at the taxpayer's discretion, rather than mandatory as reflected in the Consultation Document in Schedule E, Section 2, Paragraph 5. Companies should be able to analyze their data, draw reasonable conclusions and take a return position on an Alternative Reliable Indicator without being required to go through the advanced certainty review process.

Furthermore, we note that the Consultation Document indicates that the Commentary will include guidance on what constitutes "Reasonable Steps". Appropriate guidance in this area is necessary to allow taxpayers to properly evaluate the level of effort that would be required to gather appropriate documentation to sustain their tax positions.

Even though it provides more options for taxpayers to select indicators than the prior consultation document, the Consultation Document still places too much reliance on obtaining data from a taxpayer's clients and customers. In general, we would encourage the Inclusive Framework to deemphasize or fully drop sourcing approaches that would require Pillar One companies to source using third-party data. As noted in our comment submission on the prior consultation document on nexus and revenue sourcing, this is commercially sensitive information, and in most cases, not information that a taxpayer obtains in the normal course of business. The Consultation Document seems to reflect a belief

that the full supply chain for a given product, across different companies and geographies, is transparent, when in fact such detail is not typically available.

- For example, consider the nature of component sales. Companies supplying parts are often participating in only one of many steps in an overall value chain. More clearly stated, a seller of a component may have no contractual relationship with the seller of the ultimate finished good to which the part belongs (for example, a company selling a part to another company making a subassembly), increasing the difficulty of getting any such data from that company. Moreover, a component supplier may be supplying multiple companies within the same industry and acquiring end sales data from all its customers would provide the supplier with potentially sensitive information with respect to market share.

- In some industries, groups of parts are sold to a customer to fulfill future repairs. The customer will distribute the parts through its own organization as necessary and take responsibility for the timing and location of when these replacement parts are utilized. Shifts among initial locations may occur as needs change. The timing of installation may span different periods. All of these factors again make the determination of a truly "final" jurisdiction for components highly difficult.

- In other instances, the complexity of supply chains will lead to competitors also becoming suppliers. Disclosure of the type of information that would be required to use an Enumerated Reliable Indicator or Another Reliable Indicator could lead to competitive disadvantages that could impact the nature of the commercial relationship.

- In general, whenever a third-party intermediary is present in the supply chain, information on the final location of the customer may not be readily available. This fact pattern includes distributors, resellers, channel partners, and licensees, among others.

In addition, we note that given the burden of the sourcing information requirements, a type of overall de-minimis threshold, below which revenues would not have to be specifically sourced, would be useful. For example, it is not unusual for a company to have minor revenues related to a business that is outside their core product or service, a new experimental business line, or a similar circumstance. We encourage the Inclusive Framework to consider a general carve out to prevent a company from being required to do significant sourcing work related to a small, but distinct, revenue sources. Any such revenue instead could be sourced based on the aggregate result of the rest of the taxpayer's business.

One item that is a welcome addition in the Consultation Document is the three-year transition period (the Initial Transition Phase) before the more detailed sourcing rules take effect. However, the document states that the Initial Transition Phase would begin after the Pillar One MLC enters into force. We suggest that given the extensive data considerations, an Initial Transition Phase be put in place for any company upon its qualification for Pillar One, so that a company that is not within scope of Pillar One at the outset but falls in scope later would be able to utilize the same transition period.

With respect to nexus, we believe that the nexus threshold remains too low. Given the size of the companies that fall within scope of Pillar One, threshold amounts such as €250,000 and €1 million are very low. In many instances, the use of thresholds at this level would necessitate the use of transaction-level data, which we think is important to avoid. In addition, it should be made clear that revenues assigned under an Allocation Key would not be considered in applying the nexus threshold.

In conclusion, we would note that the ultimate resort to an Allocation Key means that the sourcing outcomes in many instances would be based on a proxy and not on a precise measure. Given this, the detailed sourcing rules seem to create an appearance of false precision that may only serve to create unintended and protracted controversy of a type that historically has been difficult to resolve and has damaged relationships between taxpayers and tax authorities. We are not optimistic that an effective advance certainty process can be developed to address these issues. We strongly encourage the Inclusive Framework to consider providing more flexibility to taxpayers with respect to revenue sourcing than is currently reflected in the Consultation Document.

Title 4, Article 5 – Determination of the adjusted profit before tax of a group (including Schedules F through H)

We encourage the Inclusive Framework to give further consideration to the following points related to the proposed calculation of Adjusted Profit before Tax (APBT), as well as its interplay with Elimination Profit (EP), the Marketing and Distribution Profits Safe Harbor ("MDSH") Adjustment and the determination of GloBE Income under the Pillar Two Model Rules.

Overall, the formulas for APBT, EP, the MDSH Adjustment and the obligation for elimination of double taxation ("EODT") are all complicated, and the inputs used are not fully aligned (e.g., the profit measurement based on consolidated financials with certain adjustments to determine the Amount A Profit allocable to a jurisdiction versus jurisdictional-level EP with another set of adjustments to arrive at the routine return factored into the MDSH adjustment and at the elimination tax base of a Relieving Jurisdiction). Furthermore, the Consultation Document does not include a clear definition of Return on Depreciation and Payroll ("RODP") of the Covered Group, nor does it sufficiently clearly indicate what depreciation and payroll expenses are included in the "sum of the Covered Group's Depreciation and Payroll" to determine the Elimination Threshold RODP. These are key concepts that must be made clear. In addition, more illustrative examples for taxpayers with different supply chain and business operating models would be very helpful. We also encourage the Inclusive Framework to do further work to unify profit and routine return formula inputs as applicable, simplify the calculations and provide taxpayers with safe harbor options for certain inputs used in the calculations.

With respect to the profit measurements relevant for the determination of the Amount A Profit allocable to the market jurisdiction (Amount Q) and the MDSH Adjustment (Amount M), we note that Covered Group APBT takes into account the book adjustment for stock-based compensation, while EP requires the use of the tax deduction amount for stock-based compensation. For certain industries, which leverage stock option plans as an incentive program to recruit and retain talent and to achieve targeted business performance, there could be a substantial divergence between the two profit measurements due to the difference in the stock-based compensation measurement. In addition, different taxpayers could have different intercompany practices on whether to cross-charge stock-based

compensation granted to employees outside of the headquarters location so as to obtain local or regional deductions. Furthermore, countries may have different rules governing the deductibility of related stock-based compensation expenses for options granted to employees of local subsidiaries. All these factors could lead to mismatches between the stock-based compensation amount in the consolidated financial statements and the sum of the deduction amounts in relevant jurisdictions. To avoid this mismatch, we recommend that taxpayers be allowed to elect between book and tax treatment of the stock-based compensation deduction when calculating the Covered Group APBT and EP and determining the Elimination Threshold RODP for the Covered Group and the payroll expense to be included in the jurisdictional RODP calculation. This approach would be consistent with the approach reflected in the Pillar Two Model Rules.

We note that one of the APBT adjustments is to include Acquired Equity Basis Adjustments (see Schedule G). These adjustments are applicable where a Covered Group acquires an Ownership Interest in another Entity that becomes a Group Entity (i.e., adjustments to address purchase accounting adjustments). These adjustments generally require the Covered Group to use the carrying value of assets and liabilities based on the pre-acquisition carrying value of the acquired Entity. This is relevant for determining depreciation, amortization, or impairment and for recognizing gain or loss with respect to the acquired assets or liabilities. Schedule I, Section 5 provides similar rules on use of historic carrying values of assets and liabilities for purposes of determining EP on a separate entity basis. However, Schedule I, Section 5, Paragraph 2 provides an exception where an acquisition of an Entity is effectively treated and taxed as if the seller sold the assets of the entity. We encourage the Inclusive Framework to include a similar exception from the use of historic carrying values in Schedule G for purposes of for Covered Group APBT. Further, Article 6.3.4 of the Pillar Two Model Rules provides another exception allowing use of carrying value for purposes of GloBE consistent with an acquisition of the underlying assets and liabilities (e.g., a Section 338 election). We encourage the Inclusive Framework to consider including a similar exception both in Schedule G for purposes of Covered Group APBT and in Schedule I, Section 5, Paragraph 2 for purposes of EP.

We also note that EP requires an adjustment to use a realization principle for certain asset and liability gains and losses, whereas the Pillar Two Model Rules provide for an election to follow book or use a realization principle. We recommend allowing such an election consistent with Pillar Two Model Rules for purposes of EP.

For the calculation of GloBE Income, the Pillar Two Model Rules provide for an election to apply consolidated accounting treatment to eliminate income, expense, gains, and losses from transactions between entities located in the same jurisdiction and part of the same tax consolidated group (see Pillar Two Model Rules Article 3.2.8). We encourage the Inclusive Framework to provide a similar election for computing jurisdictional EP.

Use of return on depreciation and payroll in Title 4, Article 6 – Allocation of profit and Title 5 – Elimination of double taxation with respect to Amount A

We are very concerned about the potentially distortive effects of the heavy reliance on RODP in these important calculations related to Amount A. This reliance on RODP can cause very different results in

similar fact patterns. Profitability is driven by much more than just depreciation and payroll, so these metrics alone are not indicative of profit level differences. In some cases, the distortion from use of RODP could result in a residual profit holder being the recipient of an Amount A allocation for reasons that have nothing to do with the objectives of Amount A. We strongly encourage the Inclusive Framework to focus on a more representative and less distortive measure than RODP. Moreover, if RODP is to continue to play a significant role in the calculations, we would stress that the use of a 40% threshold with respect to RODP is a significant source of distortion and we urge that this threshold be reduced substantially.

These concerns about the distortive effects of RODP should not come as a surprise. As highlighted in Paragraph 2.104 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, where net profit is weighted to assets, valuing assets at book value could distort results because related depreciation expenses are primarily driven by the accounting rules and not necessarily the economic values contributed by related assets: "Using book value could possibly distort the comparison, e.g., between those assets without on-going depreciation, and between enterprises that have more recent assets with on-going depreciation…"

We would underscore that these distortive effects could arise within the calculations for a company and also across the calculations for peer companies. This could cause market distortion to the extent that the effective tax rates of different companies are affected differently by the over-dependence of the Amount A results on depreciation and payroll. For example, companies with new product lines and associated new property, plant and equipment as part of their capital-intensive manufacturing facilities could produce drastically different results when compared to companies with similarly profitable, but older product lines. The difference between the accounting life and the economic life of the asset could distort the routine return measurement. While we recognize this may be viewed as a timing difference, these large timing differences could have significant effects that would create distortions in the merger and acquisition space.

We also note that companies may operate substantially different business models which could distort outcomes when considering EP and RODP. Given that the calculations are done at a point in time, businesses that carry significant up-front risks and longer life cycles could be disadvantaged. Similarly, some businesses are required to cover large liabilities on their balance sheet with self-insurance requiring operating cash as a part of their operations, which would not be accounted for in the calculation.

Furthermore, businesses look to optimize their investments based on expected returns, which would not be aligned with the RODP calculation. For example, the RODP calculation could drive a different set of outcomes for those that optimize returns by following an asset-light model (with a low payroll and asset base) versus those that do not. Similarly, outsourced business models may include several functional blocks of a value chain which are purchased from a third party. Using related parties in a separate jurisdiction could result in very different profit allocations than outsourcing to independent parties in such jurisdiction.

Title 4, Article 6 – Allocation of profit

Policy rationale for the MDSH

Pillar One is aimed at addressing concerns of policymakers that long-standing international tax rules for dividing taxing rights over global business income may not operate to allocate appropriate income to market jurisdictions. The Amount A allocation to market jurisdictions is intended to stabilize the international tax environment. We believe that this objective of stabilization would not be achieved without an effective MDSH that takes into account the profits that are allocated to such jurisdictions under the application of transfer pricing. Absent such a reduction in the Amount A allocation to a jurisdiction to reflect the residual profits already reported in such jurisdiction, disputes between taxpayers and tax administrations about the transfer pricing allocations not only would remain but would be exacerbated. Thus, we believe an effective MDSH is essential to the operation of Amount A.

Design of the MDSH

The July 2021 Statement reflecting agreement reached on fundamental elements of the Amount A calculation specifically refers to inclusion of a MDSH: "[w]here the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbor will cap the residual profits allocated to the market jurisdiction through Amount A." This makes clear that the aim of Amount A is to allocate more residual profits to market jurisdictions where a sufficient amount of such residual profits is not allocated and taxed in such jurisdictions without regard to the allocation of Amount A. Because Amount A itself does not differentiate between situations where residual profits are already allocated to the market and situations where this is not the case, the MDSH is the instrument that ensures that Amount A does not result in an over-allocation of residual profits to the market jurisdiction when combined with the profits that are allocated there without regard to Amount A. In doing so, the MDSH needs to operate to identify situations where the market is already receiving residual profits.

We believe that the MDSH formula set forth in the Consultation Document does not operate appropriately to reduce the Amount A allocation to a market jurisdiction by the amount of residual profits already allocated to such jurisdiction and thus does not serve its intended purpose.

- For example, for groups that have a similar depreciation and payroll to revenue ratio across jurisdictions, or alternatively, that have jurisdictions with higher than the group's depreciation and payroll ratio, the starting point of the calculations in the proposed formula apparently assumes that minimally a 10% return on sales (reformulated as a return on group depreciation and payroll) is an appropriate threshold for distinguishing between routine and residual profits. However, in practice, routine distributors typically receive returns significantly lower than 10%. Indeed, even disputes between tax authorities on sales and distribution related returns generally involve ranges that fall well below 10%. Thus, the threshold set in the formula would not prevent these disputes and would not stabilize the international tax environment. Even in jurisdictions in which the share of depreciation and payroll is lower than the group's share the formula would not ensure an outcome that is aligned with traditionally defined routine returns. In this regard, we would note that the FTA MAP Forum may be able to provide useful input on the appropriate threshold based on agreements reached between governments on MAPs and APAs.

- The absolute de-minimis threshold specified in Article 6, Paragraph 4 would have the opposite effect than one would typically expect from a de-minimis threshold. It would mean that companies would be subject to a full Amount A allocation to a market jurisdiction for potentially very low amounts, even if residual profits are already allocated to the jurisdiction. In contrast, such Amount A allocations would be subject to reduction under the MDSH if the de-minimis threshold is exceeded (that is, if Elimination Profit is higher, all else equal), because in those cases the residual profits already in the jurisdiction would be recognized under the formula. This means that the burden of a full potential Amount A allocation would be incurred when a company is below the de-minimis threshold (rather than above it). We do not think this is the appropriate result.

- It is important to recognize that residual profits can also be taxed in the market jurisdiction in the hands of independent distributors. Not considering these situations in the MDSH Adjustment, especially taking into account that sales through independent distributors are accounted for the nexus determination, would create economic distortions between wholly owned supply chains and those that include third-party distributors.

- The use of RODP as a factor in the proposed formula for the MDSH Adjustment also would create potential distortions. A cost-based remuneration for distribution activities is seldom used in practice. The use of RODP would mean that capital intensive businesses would be less likely to benefit from the MDSH Adjustment. The approach appears to reflect an assumption that the more activities are undertaken, the higher the routine returns are; however, more extensive activities may result in higher residual returns.

- We see no policy basis for the alternative 40% RODP jurisdictional threshold and urge that it be dropped.

- Finally, we do not understand the role of the two additional parameters that have been included in the proposed MDSH Adjustment formula, specifically, the offset percentage Y and the multiplier for lowering the Elimination Profit of the Covered Group in Paragraph 6. We urge the Inclusive Framework to provide further information about the policy purpose of these two parameters as well as to specify the values proposed to be used for them. We further believe it would be important to provide an opportunity for further stakeholder comment on the practical implications of these parameters based on such additional information if the Inclusive Framework decides to further develop them.

Treatment of withholding taxes under the MDSH

We also would like to address the treatment of gross-basis withholding taxes on deductible payments in market jurisdictions under the MDSH. While the Consultation Document indicates that the treatment of withholding taxes is still under discussion by the Inclusive Framework, we believe the appropriate treatment is clear. At a fundamental level, if Amount A is intended to address a concern that market jurisdictions do not have “enough” taxing rights under existing international tax rules, that determination should take into account all income taxes the jurisdiction imposes, whether it chooses to exercise its taxing rights through a gross-basis withholding tax on deductible payments or through a tax on net income.

For example, consider a company in market jurisdiction A that has €1000 of third-party sales and deductible payments of €950. If market jurisdiction A has an income tax rate of 10%, the market jurisdiction would impose €5 of tax on the €50 of net income. Now consider the company's identical operations in market jurisdiction B, which has the same income tax as market jurisdiction A and also imposes a 30% withholding tax on certain deductible payments. If the company has €100 of such payments, market jurisdiction B would impose total taxes of €35, which reflects an implicit tax on income of 70%. Put differently, it is 'as if' Jurisdiction B is imposing its 10% tax on 'profits' of €350 (notwithstanding that actual profits are only €50). It would be implausible to claim that market jurisdiction B does not have enough taxing rights over this company.

While we appreciate that net income taxes and gross-basis withholding taxes are distinct policy choices, it would clearly be contrary to the policy objectives of Amount A if gross-basis withholding taxes were to be ignored. Moreover, implementation of Amount A in such a manner would be inherently unstable, as jurisdictions could impose withholding taxes at will, without any risk that such a policy choice would negatively impact their additional taxing rights under Amount A.

We believe that withholding taxes must be taken into account in the MDSH. For illustration, this could be done under the currently proposed formula by increasing the measure of Elimination Profit by the amount of the withholding tax base (e.g., royalty payments) adjusted to reflect the difference between the withholding tax rate and the income tax rate. This would treat the withholding tax as if it were a net income tax for purposes of the MDSH. Accordingly, the currently proposed formula would be modified to the following:

$M = Min ((EP + (D) * (Wr/t)) – PEP) x [Y\%], Q)$

The additional parameters reflected in the above are as follows:

Wr = Withholding tax rate;

D = deductible payment subject to withholding tax; and

t = income tax rate.

Title 5 – Elimination of double taxation with respect to Amount A (including Schedules I and J)

We are concerned that the EODT rules provided in the Consultation Document could lead to outcomes that do not seem to be aligned with the policy intent of Amount A:

- Jurisdictions with a significant tangible asset base or payroll would be less likely to be required to eliminate double taxation on Amount A; and
- Because of the tiering approach, the obligation to eliminate double taxation on Amount A could be disproportionately borne by a relatively small number of relieving jurisdictions.

Bias created by the use of RODP as a measure for tiering

The stated policy goal of Pillar One is the reallocation of residual profits from jurisdictions that are otherwise entitled to such profits under the arm's length principle to market jurisdictions where users or customers are located. In achieving that aim, it is critical that the reallocation be principles-based and

not biased or arbitrary – which would otherwise counter the objective of the rules to create a more stable international tax system.

The pure RODP approach may be seen to be arbitrary in that it makes it far less likely for jurisdictions with large tangible asset or payroll bases to be required to relieve Amount A. The fact that an entity in a particular jurisdiction has high tangible assets and payroll may merely indicate that it performs significant routine functions. At the same time, the entity could also derive residual profits generated by customer and user behavior in market jurisdictions. The performance of routine functions and earning of residual profits are not mutually exclusive. Thus, the linkage to tangible assets and payroll does not dovetail neatly with the objective to identify the location of residual profit within the group.

We also note that the definition of residual profit in Tiers 2, 3A and 3B based on RODP is inconsistent with the definition of deemed residual profit in the Amount A tax base calculation, without any clear policy basis for the differences.

Situations where the obligation to eliminate double taxation with respect to Amount A would be disproportionately borne by a small number of Relieving Jurisdictions

Under Article 9, the effect of ordering Specified Jurisdictions in Tiers 1 and 2 according to tangible asset and payroll criteria is that the burden to eliminate double taxation under the rules would fall on a subset of jurisdictions where intangible profit earning entities with lower tangible assets and headcount are located. This could lead to an outcome where one or two jurisdictions would bear almost all the cost of Amount A allocations, shielding jurisdictions in lower tiers from this obligation – even if the entities in lower-tier jurisdictions are performing activities more proximate with the market and more closely linked to the residual profits that Pillar One proposes to reallocate. The rules as currently drafted would lead to the perhaps surprising consequence that jurisdictions where headquarter and significant market entities are located would bear no obligation to eliminate double taxation with respect to Amount A, despite often being larger and more profitable (likely with a substantial portion of their profits constituting residual profits).

We also believe that clarifications are needed with respect to several aspects of the EODT formula.

Definition of Elimination Profit for the purposes of EODT

The phrase "Elimination Profit" in reference to a covered group in a jurisdiction is used throughout Title 5. We assume this is intended to refer to the MDSH-adjusted Elimination Profit described in Title 4, Article 6, Paragraph 6 as opposed to the definition of Elimination Profit (or Loss) of a Covered Group for a Period in [Jurisdiction Name] in Title 7, Paragraph 30. This could be clarified through an explicit statement regarding which Elimination Profit is being referenced in Title 5.

Identification of Specified Jurisdictions

Article 8 provides some measures to simplify the number of jurisdictions that could potentially be Specified Jurisdictions under the rules. In particular, the smallest number of jurisdictions that comprise 95% of the Covered Group's EP would be considered as Specified Jurisdictions. We would suggest that this threshold is so high as to make the simplification meaningless. Similarly, we question the need for a separate €50 million trigger. In addition, the 95% threshold test does not seem to account for a fact pattern where one of the jurisdictions is loss making.

These measures could result in a very large number of Specified Jurisdictions for which a taxpayer would be required to calculate EP, but which may not in fact be Relieving Jurisdictions.

Interpretation of Article 9

Article 9 is confusing and difficult to interpret. Paragraphs 6 through 8 in particular employ cumbersome language. The rules would be significantly enhanced by spelling out the formulas supplemented with illustrative examples.

Tiering of jurisdictions

We believe that the intention is that an entity could be classified as both Tier 1 and Tier 2, and as both Tier 3A and Tier 3B. However, this is not readily apparent in the Consultation Document and should be clarified.

Interaction between MDSH and EODT

It would be valuable to have an example of how the interaction between the MDSH and the EODT rules is intended to work mechanically. Paragraph 6 would seem to indicate that the MDSH is applied at a jurisdictional level, which would mean first calculating the MDSH Adjustment at an entity level, then calculating EP at a jurisdictional level, and then netting the MDSH Adjustment against jurisdictional EP. The intended ordering could be made clearer through an example.

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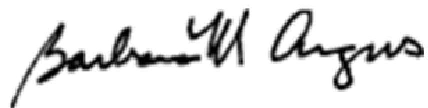
The global EY team that prepared this submission welcomes the opportunity to discuss these comments in greater detail and to continue to participate in the dialogue as the Inclusive Framework advances the work on this important project.

If there are questions regarding this submission or if further information would be useful, please contact Tracee Fultz (tracee.fultz@ey.com), Marlies de Ruiter (marlies.de.ruiter@nl.ey.com), Mike McDonald (michael.mcdonald4@ey.com) or me (barbara.angus@ey.com).

Yours sincerely, on behalf of EY,



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