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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](mailto:tfde@oecd.org)

Re: OECD's Public Consultation on the Progress Report of Amount A of Pillar One

Dear Secretariat Team,

PwC International Ltd on behalf of its network of member firms (PwC) welcomes the opportunity to share its views on the Progress Report on Amount A of Pillar One of the project Addressing Tax Challenges of the Digitalization of the Economy. In view of our understanding of the nature and urgency of the request, as well as the limited turnaround, we set out below our comments on several important design features of Amount A which we believe the Inclusive Framework (IF) should address as part of its program of work.

While it is clear that progress has been achieved in a number of areas, it is equally clear that considerable work remains to be done for the IF to finalise and reach agreement on the technical aspects of Pillar One. We therefore welcome the revised timeline, which we hope will allow stakeholders to consider and provide further input on key areas that remain unresolved (e.g., the treatment of withholding taxes). Further engagement with stakeholders (particularly with in-scope businesses) will be necessary to ensure these rules are administrable, consistent with initial policy objectives, and do not create unintended distortions.

Our comments below are organised under the relevant sections of the Progress Report:

### **Title 1: Scope**

#### **a. Disclosed Segments**

In certain circumstances, an MNE may not meet the Pillar One scope requirements, but a Disclosed Segment of the MNE may meet such requirements. In those circumstances, Amount A determinations will be disaggregated to a "Segment Financial Accounting Profit (or Loss)". In addition to adjustments to financial accounting income (or loss), this disaggregation by segment will be derived from the consolidated financial statements, as determined under the related accounting standard (e.g., US GAAP, IFRS or other acceptable standard). Importantly, segment outcomes included in a consolidated financial statement may differ depending on the relevant applicable accounting standard. Moreover, segment reporting may change in future reporting periods (e.g., as a result of internal reorganization), which may create further complications.

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## b. Extractives Exclusion

The proposed rules contain significant improvements to the original consultation proposals, particularly with respect to the methodology for identifying out of scope activities and additional measures to simplify compliance.

There are, however, a number of areas where interpretation of the proposed rules remains uncertain. For example:

- How revenue recognised/ excluded in respect of segments and entities is identified and in particular how intra-group transactions within the same segment are treated. This is relevant to both the “short-cuts” proposed to the non-Extractives revenue test, as well as the broader revenue tests.
- The definition of Primary Processing and how this applies to particular products which have not been positively identified as being within (or outside) of such processing.
- The definition and scope of application of the Arm’s Length Principle.

We encourage further discussion regarding the specific drafting of the rules to ensure the policy intent of excluding economic rents from extractive activities and minimising compliance costs are achieved.

We also encourage further consideration of the scope of the Interim Transitional Provisions to ensure they appropriately limit the compliance burden over the transitional period. We suggest this includes consideration of extending the transitional concessions to exclude the Jurisdiction of Extraction concept for groups applying the Entity approach (in a manner similar to that proposed for groups applying the Segment approach).

## c. Regulated Financial Services Exclusion

We welcome the confirmation that the exclusion for regulated financial services will cover regulated financial services broadly and not distinguish between different parts of the industry. Also, the definition of regulated financial services has been widened to include credit institutions, which should result in more financial services entities which carry out lending activities to fall within the scope of the carve out.

Although there will still be some complex calculations required by groups to demonstrate that their ‘Non-RFS Revenues’ do not exceed the EUR 20 billion threshold, in our view the rules take a sensible approach in setting out how a group can demonstrate this in a simplified calculation.

### **Title 3: Nexus and revenue sourcing rules**

#### a. Revenue Sourcing Rules

While the new rules provide added flexibility, they still require (except where an allocation key is applicable), that revenues 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, and their quantities and prices. For transport services, the draft rules (without explanation) require the use of prescribed allocation keys in all cases. This may raise a question of equitable treatment and why Covered Groups in that one industry are denied the use of an “Alternative Reliable Indicator” under the proposed rules which allow Covered Groups in other industries such flexibility.



The new rules ostensibly eliminated the transaction-by-transaction language, but this appears to be a distinction without a difference practically insofar as businesses must still go through the process of delineating transactions involving goods, services, licences, and other content.

#### **Title 4: Determination and allocation of Taxable Profit**

##### **a. Determination of the adjusted profit before tax of a group**

Similar to Pillar Two determinations, inputs for "Adjusted Profit Before Tax" with respect to the tax base of Amount A under Pillar One are derived from Financial Accounting Profit (or Loss), with a number of specified adjustments. While there are certain similarities between the adjustments for Pillar One as compared to Pillar Two, there are important differences. Moreover, for purposes of the Marketing and Distribution Profits Safe Harbour (MDSH) under Pillar One, a determination of an "Elimination Profit (or Loss)" from financial reporting outcomes requires further adjustments than those required for Amount A, and further differs from required adjustments under Pillar Two. Differences in the tax bases, both within the Pillar One Model, as well as differences from the Pillar Two Model, will result in significant administrative burdens, including but not limited to the creation and maintenance of multiple separate books and records for the various tax bases. This is particularly true for the Elimination tax base, which is determined at the disaggregated "Group Entity" level, and could be further complicated by ongoing consideration for non-controlling interests.

Moreover, many other inputs for determinations under Pillar One, including gross revenues (by jurisdiction) and other data with respect to inputs for the MDSH and identified Allocation Keys will be sourced from financial reporting data. As an example, jurisdictional revenue derived from the financial reporting accounts will need to be analyzed for certain nexus tests, and additionally will need to be evaluated under a complex series of sourcing considerations. As financial reporting processes may not capture this data in a manner sufficient to evaluate under the suggested Pillar One Model, additional administrative complexities and efforts may result.

##### **b. Loss Carryforward**

We understand the overarching premise of Amount A to be to ensure that a portion (specifically, the reallocation percentage of 25 percent) of a Covered Group's "residual profits" is subject to tax in eligible market jurisdictions. And within this premise, "residual profits" are profits in excess of 10 percent of the Covered Group's third-party sales revenues. Therefore, it stands to reason that companies that do not have residual profits should not be subject to Pillar One rules and the Amount A tax base of a Covered Group should truly be a portion (specifically, the reallocation percentage) of residual profits. Profits in excess of 10 percent of revenues in a given year do not represent residual profits for a company – under the construct of Amount A – if that company has incurred losses leading up to the current year. In fact, profits in excess of 10 percent of revenues in a given year do not represent residual profits if the company in question has incurred "profit shortfalls" (or "residual losses") in prior years. In each such instance, the appearance of residual profits in a current year are just that – *apparent* residual profits not *actual* residual profits. Those profits are a return on prior investments that cover prior years' losses (or profit shortfalls).

In order for the tax base calculation to be consistent with the overarching premise of Amount A – i.e., a reallocation of actual residual profits to market jurisdictions – the measurement of residual profits in a given year should not be overstated. As such, Article 5, paragraph 3 should consider an "Eligible Period" that is (significantly) longer than three years for "pre-implementation" losses. Furthermore, Article 5 should be expanded to account for "profit shortfalls" in prior periods – profits below 10 percent of revenues – in the determination of Amount A in the current year.



### c. Allocation of Profit

After determining its Adjusted Profit Before Tax, an in-scope group will calculate a share of such Adjusted Profit, called Amount A, using a formula based on a definition of normal or routine profit equal to 10 percent return on sales (ROS). A threshold/ benchmark of 10 percent ROS is not in line with the ALP and it is not based on any economic evidence or legal argument. This implies that that threshold will be easy to change in the future (because there is no underlying principle which anchors it), raising questions about the stability of the formulas underlying Pillar 1, even if the formulas will be embedded in the Multilateral Convention (MLC). The same comment would apply to the mechanism for elimination of double taxation and the MDSH which are all defined on the basis of formulas that are not backed by economic or legal analysis.

To enhance the clarity of the legislation, it should be specified whether “R” (Revenues of the Covered Group for a Period) refer to the overall, global revenues of the group or, instead, only to the sum of the revenues derived in countries that are above the nexus threshold (i.e., EUR 1 million for large jurisdictions and EUR 250,000 for jurisdictions with Gross Domestic Product less than EUR 40 billion).

## **Title 5: Elimination of double taxation with respect to Amount A**

### a. Elimination of double tax rules

As a general matter, we have grave concerns about the inconsistent criteria within the double tax rules and the overall architecture of Amount A. Amount A is based on an approximation of residual profits, which are reallocated to market jurisdictions. The criterion to identify the amount of such residual profits has been stable over the course of the project and is reflected in article 6 as the excess of 10 percent of revenue. It is unclear, however, why this same criterion is not used to identify the jurisdictions obligated to eliminate double taxation. Given that detailed revenue sourcing rules have been developed for different categories of revenue for purposes of allocating Amount A, the calculation of residual profits as those in excess of 10 percent of revenues (sourced to a jurisdiction under the applicable rules) presents a feasible way of computing residual profits at the jurisdictional level. The obligation to relieve double taxation can be allocated among relieving jurisdictions with residual profits identified in such a manner. That computation would potentially be simpler and not require additional concepts (e.g., return on depreciation and payroll) or measurements (e.g., depreciation and payroll at the jurisdictional level). However, the Progress Report does not provide an explanation or policy rationale for why one approach should be preferred over the other. Rather than allocating the obligation to jurisdictions with profits over 10 percent of revenue, the obligation would fall to jurisdictions with higher returns on Depreciation and Payroll (DP). Although it is difficult to construe that using Return on DP (RoDP) has no effect whatsoever in preemptively selecting jurisdictions/ corporations with no substantial business base (e.g., a simple IP owner), RoDP is inappropriate in selecting entities that earn residual profits as “paying entities,” and adds yet another complexity to already very complex rules. It is therefore likely to cause a split between the jurisdictions in which profits in excess of 10 percent of revenue arise and the jurisdictions in which the obligation to eliminate double taxation would be allocated. For instance, a high RoDP could be caused by exhausted depreciation of productive assets. In addition to potential fairness concerns, this system would create yet another layer of complexity, increasing the risk of unforeseen effects. For instance, Depreciation refers to assets “located” in a jurisdiction (schedule J, 4), while Payroll seems not to reflect this same requirement (as indicated in footnote 22 of schedule J) and it could have a distorting effect on business decision-making (e.g., assets: purchasing vs. leasing a building, human resources: employing vs. outsourcing).



Another policy concern we have with the elimination of double tax regards is the vagueness regarding relieving jurisdictions. The elimination rules specify which jurisdictions are obligated to provide relief relating to Amount A Profit for a Covered Group. Without further detail it is difficult to apply the rules to/in a “jurisdiction” rather than to “entities” that are the taxpayers in the relevant domestic tax systems and that earn the residual profits, as it is the functions performed and risks assumed by entities within a group that generate residual profits, not the jurisdiction. The rules are introduced without explanation of the policy intention underpinning the rules and the process. A basic request would be for the rationale to be specifically articulated. It is difficult to comment constructively on whether the rules achieve their intended effect without such an explanation.

The elimination rules appear to have been developed iteratively as part of a political negotiation, and without further articulation the suspicion will remain that this outcome (and others) is completely results-oriented, rather than policy driven. Furthermore, this result is an extremely complicated process which is hard to understand, and will be incredibly difficult to administer. In very simplified terms, the jurisdictions with the highest RoDP will have the greatest obligation to provide relief relating to Amount A Profit. In many cases this will mean that companies which own proportionately high levels of IP, relative to employees and tangible fixed assets, or which earn a high proportion of their returns as interest will be entitled to relief, but it is questionable whether this relief can be effective if the Amount A Profit (before reallocation) arises elsewhere in the Covered Group (i.e., in a different jurisdiction). Further, there is no provision for the segmented allocation of Amount A tax liability - where appropriate, it might be worth considering either excluding jurisdictions with no nexus to the business segment where major/significant residual profits of the Group occurred or allocating the burden to eliminate double taxation on a segmented basis.

As noted in footnote 3, it is possible that where a ‘routine’ sales entity posts a high return on sales, this could easily translate into a relatively high RoDP, and that such entities could therefore be entitled to relief relating to Amount A Profit.

Another point to note is the question of what the Amount A profit actually relates to. If, as will often be the case, IP-related profit is being reallocated, then in many cases tax will have been withheld at source on royalty payments to the jurisdiction whose profit is now being reallocated back to the source jurisdiction. Should the source jurisdiction be able to tax this profit again? Some kind of netting mechanism may be appropriate. We would be happy to provide input into the design of such a mechanism.

The overall point, though, is that the formulary Amount A, which, by definition, actively tries not to characterise the profit in the system, has to interact with Withholding Taxes, Duty and Transfer Pricing rules which do require it to be characterised.

We also reiterate that there are as yet no rules for splitting a jurisdictional liability/entitlement to relief between legal entities within the jurisdiction. Such rules will be important to create a workable system and to ensure certainty both from a tax and financial accounting standpoint.

#### b. Marketing and Distribution Profits Safe Harbour (MDSH)

We assume that the overarching purpose of the MDSH is as stated in the October 2021 IF Statement, which is to cap the residual profits allocated to market jurisdictions through Amount A when (at least some portion of) “residual profits of an in-scope MNE are already taxed in a market jurisdiction.” This view is also consistent with what was stated in the October 2020 Blueprint. Given that objective, we note that the formulation of the MDSH in the Progress Report represents a marked change from what was put forward (for discussion) in the October 2020 Blueprint. Indeed, it may reasonably be argued



that the present formulation – because it neither involves a comparison of the MDSH amount to the actual profits attributable to sales and marketing activities nor quantifies the MDSH amount itself in a manner that is tied to jurisdiction-level sales or marketing and distribution activities – has little to do with “marketing and distribution” and is more of a “residual profit” safe harbour. This raises questions on how the MDSH will interact, and reconcile with, Amount B. This is because the MDSH in the Progress Report seeks to delineate routine profits based on RoDP and residual profits as those in excess of such deemed routine profits. In contrast, Amount B – also intended to represent routine profits – would likely be expressed as a percentage of sales. However, for purposes of this letter we take the overarching design choices already made for the MDSH (as proposed in the Progress Report) as given and focus on specific aspects of that formulation that may need additional refinement.

We interpret the formulation of the MDSH in the Progress Report as seeking to identify residual profits (or lack thereof) at the jurisdictional level by comparing reported profits – specifically, elimination profit (EP) – with a measure of profits intended to represent routine profits – specifically, that portion of EP (PEP) which is calculated by applying a rate of return to the DP for the jurisdiction. In turn, the rate of return is one of two possible figures – the elimination threshold (ET) RoDP for the Covered Group or 40 percent, whichever is greater. Of those two figures, only the ET RoDP for the Covered Group is a company-specific measure and bears some relation to a notion of routine profits – at least in a manner consistent with how routine profits are demarcated in the Amount A formula. This is because the ET RoDP is derived by dividing the group wide (or segmentwide, as the case may be) profits amounting to 10 percent of third-party revenue – which is taken to be a proxy for total routine returns in the Amount A formula – and devising this by the group wide (segmentwide, as the case may be) figure for DP. The ET RoDP thus maintains a semblance of internal consistency with the overall Amount A formula and its constituent elements. Furthermore, it may be argued that where 10 percent of sales serves as the delineation point for routine profits at the group (or segment) level in the Amount A formula, the ET RoDP – which expresses the same level of profit as a percentage of DP – serves as an equivalent delineation point for routine profits at the jurisdiction level (subject to some of the reservations expressed about this measure, above). Further, since this figure will vary by company based on such company’s “intensity” of DP relative to sales, the ET RoDP can be viewed as accounting for company and industry differences to some extent.

In contrast to the above, however, the 40 percent figure in the PEP appears wholly arbitrary and bears no semblance of connection to “routine profits” for a Covered Group (as a RoDP). For instance, it is quite conceivable that for companies and industries that are DP intensive, the figure for rate of return on DP that measures routine profits is well below 40 percent. In such instances, the current formulation of the PEP will result in a gross overestimation of deemed routine profits at the jurisdiction level and a consequent underestimation of residual profits (i.e., EP less PEP) for purposes of the MDSH. The result of this series of distortions will be to deny the benefit of the MDSH to Covered Groups that otherwise should be entitled to that benefit given the overarching purpose/rationale of the MDSH. In light of this, we strongly recommend removing the 40 percent “floor” in the determination of the PEP within the MDSH formulation.

Our second comment deals with a mathematical misspecification (or at the very least, an incompleteness in the specification) of the MDSH adjustment. Article 6, paragraph 5 specifies the MDSH as follows (with all terms having the meaning as defined in the Progress Report):

$$M = \text{MIN}((EP - \text{PEP}) \times [Y\%], Q)$$

We note that one of two refinements need to be made to the above. Either there needs to be a clarification that the PEP cannot exceed the EP for purposes of the above calculation such that the



term (EP - PEP) is never below zero in the formula for M. Alternatively, the formula for the MDSH should be modified as follows:

$$M = \text{MIN}(\text{MAX}((EP - PEP), 0) \times [Y\%], Q)$$

One of the above refinements is necessary to ensure that the MDSH adjustment does not yield distortionary outcomes. Given how the PEP will be calculated, there is no guarantee that this will always be lower than the EP in a given jurisdiction. Absent one of the above suggested refinements, the MDSH formulation will yield a negative value for M in the formula as presented in Article 6, paragraph 5. This would then result in an *addition* to the (pre-MDSH) Amount A allocation to a given jurisdiction – an outcome that is entirely at odds with the stated goal/objective of the MDSH.

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With this letter we kindly invite you to take our observations into consideration during further development of the Pillar One rules. We stand ready to discuss the issues raised in this letter in more detail, if that would be helpful at any point - please do not hesitate to contact me or one of the individuals set out below.

Yours sincerely,

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