

OECD releases Multilateral Convention to implement Amount A of Pillar One

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In brief

The OECD on 11 October 2023 [released](#) a package of guidance in relation to Amount A of Pillar One: the text of a consensus-based [Multilateral Convention \(MLC\)](#) and accompanying [explanatory statement](#), an [Understanding on the Application of Certainty for Amount A of Pillar One \(UAC\)](#), and an update to the [economic impact assessment](#) of Pillar One. The OECD also published [factsheets](#) and a high-level [overview](#) of the content, operation, and layout of Amount A including a process map with steps for applying the rules. Despite running to approximately 850 pages and approved for release by the Inclusive Framework (IF), the release does not open the MLC to countries for signing at this point, because there are still issues to be resolved.

For the MLC to enter into force, it needs to be ratified by at least 30 jurisdictions including the headquarters jurisdictions of at least 60% of multinational enterprises (MNEs) currently expected to be within Amount A's scope (this cannot be met without the United States). With the United States having opened a 60-day [public consultation](#) on the MLC on the same day as the OECD's release, and subsequent comments from US Treasury Secretary Janet Yellen indicating countries will work into 2024 to settle issues, it is still unclear what it will actually take to gain sufficient ratification support.

The MLC, Explanatory Statement, UAC, and Implementation Handbook were included as Annexes to the OECD Secretary-General tax report to G20 finance ministers and central bank governors for their 12-13 October meeting in Marrakech, Morocco.

We focus in particular in this Bulletin on changes from the [2022 Progress Report on Amount A of Pillar One](#).

The takeaway: The Amount A MLC moves toward destination-based taxation, by requiring in-scope MNEs to calculate a new sales and profit base which is different from, and potentially more complicated than, the Pillar Two base. The compliance burden will be significant. The MLC retains most of the complex architecture described in the nine prior consultation documents, but there are some noteworthy changes:

- The introduction of an “autonomous domestic business exemption” to disregard financial results that are derived from certain jurisdictions where domestic-oriented businesses operate (e.g., for MNE groups with decentralised business models and limited intercompany transactions). The inclusion of this exemption is welcomed because it may reduce instances of double counting, but its thresholds are restrictive and will be a continued area of focus.

- The intricate modifications to the marketing and distribution safe harbour (MDSH) will result in a higher allocation of profit to market jurisdictions in most cases, though the inclusion of a gross-up for withholding taxes (WHTs) irons-out one potential source of double-counting.
- Binding (and in most cases, mandatory) arbitration for “related issues,” notably the material transfer pricing, business profit, or withholding tax characterisation issues which dictate the pre-Amount A profit landscape, would represent a significant achievement.

In detail

Amount A

The MLC consists of seven parts with 53 Articles and nine Annexes, which cover Amount A, tax certainty (for Amount A and amounts related to Amount A), as well as digital services taxes (DSTs) and relevant similar measures. To comply with Amount A, MNEs will have to apply a set of rules that can be broken down into five basic steps explained in the overview.

- Step 1: Determine if an MNE is in scope
- Step 2: Identify eligible market jurisdictions
- Step 3: Calculate and allocate a portion of excess profit
- Step 4: Eliminate double taxation
- Step 5: File, pay, and access to tax certainty

Step 1: Determine if an MNE is in scope

Main provisions

Under Pillar One, a formulaic share (Amount A) of the consolidated profit of certain MNEs will be reallocated to markets (i.e., where sales arise). Pillar One will apply to MNEs with profitability above 10% and global turnover above €20 billion. The profit to be reallocated to markets will be calculated as 25% of the profit before tax in excess of 10% of revenue. The revenue threshold may be reduced from €20 billion to €10 billion seven years after the MLC’s entry into force. This change is subject to a review by a “Conference of the Parties” (CoP) which is established to make decisions or exercise functions required for the interpretation and implementation of the MLC.

The averaging mechanisms outlined in the 2022 Progress Report remain largely unchanged. As previously established, the revenue test applies to the current period only and the profitability test applies to the current period and, where an MNE has never been in scope or where it has been out of scope for two consecutive periods, the average test and prior period test apply.

Segmentation

The provisions for application of Amount A to Disclosed Segments that were added to the 2022 Progress Report have been retained. A Disclosed Segment is defined as any segment reported in the consolidated financial statements of the Ultimate Parent Entity of a Group under an Acceptable Financial Accounting Standard, which includes IFRS, the Generally Accepted Accounting Principles of a range of stated countries (including US GAAP) or an equivalent accepted by the CoP. These rules will apply in exceptional circumstances where an MNE with more than €20 billion of revenues does not meet the 10% profitability scope requirement, but a Disclosed Segment of

that MNE meets both the €20 billion revenue and the 10% profitability thresholds. In these circumstances, the Amount A rules will apply to such a Disclosed Segment as if it was an independent business from the rest of the MNE, and part of the Disclosed Segment's profits will be reallocated to the market country where the products and services of the segment are provided to the consumer.

Autonomous domestic business exemption

The autonomous domestic business exemption is an important new feature which removes financial results that are substantially all domestically focused in a jurisdiction and represent a "closed system" with minimal intra-group and cross-border transactions. In essence, these are determined by reference to meeting all the conditions relating to:

- Cross-border intra-group revenues and expenses of Group Entities located in the jurisdiction not exceeding 15% of the total revenues or expenses, respectively, of those Group Entities; and
- Third-party revenues booked by Group Entities in the jurisdiction (after eliminating intra-group transactions) being substantially all also sourced to the jurisdiction, i.e., being between 95% and 105% of the total third-party revenues of those Group Entities.

Observation: The basic Amount A mechanism blends the global profits of an MNE, so that the Amount A allocation to markets that are less profitable is subsidised by markets that are more profitable. Profitable jurisdictions with few cross-border sales or purchases have questioned whether this cross-subsidy is appropriate, and this exemption goes some way to addressing the issue. Note that few MNE members undertake activities that are totally contained within a single jurisdiction, service charges and royalties will be a common feature, and the 15% threshold is likely to be a key area of focus as MLC negotiations progress in 2024.

Other exclusions

Apart from purely domestic-oriented business, scope exclusions also apply to specific industries.

- **Qualifying Extractives Group** - The MLC sets out rules for Amount A taxing rights to be excluded for a "Qualifying Extractives Group" that meet specific criteria. In addition to expanding on the operation of the extractives exclusion provided for in the 2022 Progress Report, the MLC sets out simplified methodologies that will apply for the "Initial Extractives Transition Phase." It also allows implementing jurisdictions to adopt a simplified exclusion methodology, though the application of this simplified approach is subject to a majority of the Group's extractive revenues being generated in jurisdictions that have made that choice.
- **Financial Services** - As previously announced, regulated financial institutions will not be in scope of Amount A. Further detail is included in the MLC on how the financial services exclusion will operate. There are two options available to isolate the financial services results within a Group, either by way of excluding the revenues and profits of individual regulated financial institutions or by electing to use a Disclosed Segment approach, whereby the results of an entire segment, which meets the definition of a regulated financial services segment, can be excluded.
- **Defence** - There is an exclusion from Amount A by reference to a fairly broad definition focused on supplies related to defence or intelligence services. The relevant governmental supplies are those procured by or used by specified bodies for such services or where such services protect export-controlled security interests. Other supplies are covered where the disclosure of related information is prohibited by law designed to protect security interests preserved by such services.

Step 2: Identify eligible market jurisdictions

Nexus and revenue sourcing

The nexus test in the draft MLC (Article 8) is relatively unchanged as compared to the 2022 Progress Report. Once an MNE has determined how much revenue it generates in each of its market countries, Amount A profit will be reallocated only to the market countries where the MNE meets a quantitative special purpose nexus test. This test is satisfied when an MNE generates more than €1 million in revenues in a market country (as determined under the revenue sourcing rules). A lower nexus threshold of €250,000 applies where a country's GDP is lower than €40 billion.

The broad system in place for revenue sourcing as described in the 2022 Progress Report has also remained substantively the same in the draft MLC (Article 7), with much of the added flexibility retained from the prior version. The draft MLC mainly attempts to respond to comments received on the revenue sourcing rules in prior consultations. For example, some of the ambiguity around whether certain aspects of the sourcing rules were supposed to be applied on a transaction-by-transaction basis has now been clarified. There were also concerns that application of the revenue sourcing rules required companies to obtain information from customers to support their positions, which have now been addressed. Finally, there is now additional information included in the MLC on the internal control framework requirement for revenue sourcing.

Observation: There is greater clarity around application of the rules and more of the flexibility that business called for, although there remain some challenges in determining an appropriate (and most efficient) approach, and the tax certainty opportunities in this regard will be welcome.

Step 3: Calculate and allocate a portion of excess profit

Marketing and Distribution Profits Safe Harbour (MDSH)

The MDSH adjustment serves as a reduction to the Amount A allocated to an eligible market jurisdiction. It has progressed in its design but remains very complex. Calculating the MDSH adjustment now entails three different steps (outlined below), five different ratios, and four different types of jurisdictional profits:

- Identify the “elimination profit” in the market, which is financial accounting profit after making certain adjustments as per the MLC (Annex B, Section 4). Agreement has largely been reached on WHTs to be taken into account, but WHTs on dividends, capital gains and payments to out-of-scope MNEs are not included. There can be downward WHT adjustments in the determination of the jurisdictional elimination profit (which is the starting point for the calculation of the MDSH) - this is to account for the tax credits given by a resident jurisdiction for the same WHT that is being applied in a source jurisdiction. The upward WHT adjustment is then made to determine the jurisdiction-level “adjusted elimination profit.” The upward adjustment is intended to reflect the withholding taxes levied on outbound payments from that jurisdiction. These are all aspects on which certain countries continue to disagree.
- Calculate the jurisdiction-level “excess profit” by subtracting from the adjusted elimination profit a measure of routine profits. That measure of routine profits is the greater of two numbers: (i) the jurisdiction's depreciation and payroll multiplied by the elimination threshold return (which is 10% multiplied by adjusted revenues and divided by the sum of depreciation and payroll) or (ii) 3% of the adjusted revenues sourced to that jurisdiction (under the revenue sourcing rules).
- Reduce the resulting excess profit further by applying one of three possible offset percentages that applies to a specific jurisdiction: 90%, 25%, or 35%. This was not previously specified in the 2022 Progress Report.

A 90% offset percentage applies to so-called “low depreciation and payroll” jurisdictions. The figure of 25% applies to low-income jurisdictions while 35% applies to all others.

Observation: The two final stages guarantee that solely a portion of the excess profit situated in a market may offset Amount A. The final three ratios are at the lower end of the range proposed in the previous consultation, with 35% seeming likely to be the most commonly applicable ratio. In most cases this approach will allocate substantially more profit to market jurisdictions than most observers might have assumed.

The MDSH presents a notably complex facet of the Amount A rules, necessitating the MLC to define approximately 10 new concepts for its operationalisation. Furthermore, Brazil, Colombia, and India have reservations on various aspects of the MDSH so further changes may be required, potentially adding additional complexity in order to reach final agreement on the MDSH.

The MDSH does not apply if the profit in a jurisdiction is small (less than €50 million), a clear effort to ensure that smaller or less profitable markets such as those in developing economies receive a material level of Amount A.

Step 4: Eliminate double taxation

The elimination mechanism identifies which jurisdictions will be required to grant relief for Amount A. The basis on which liability is determined follows the approach set out in the 2022 Progress Report. The process involves a complicated series of calculations through which the liability to relieve Amount A basically falls on the entities with the highest profit relative to their combined depreciation and payroll expense. Covered WHTs collected in a source/market state are converted into a profit amount (through a formula) and then deducted from the jurisdictional profit that is the basis for allocating the obligation to relieve double taxation. The rules on elimination of double taxation are among the most complex within Amount A with a tiered structure to categorise “relieving jurisdictions” and then allocating the obligation to provide double tax relief among those jurisdictions in a sequential and complicated manner.

It is technically possible for an Amount A liability to arise, but for there to be insufficient profit in relieving entities to meet the liability. In such cases the unrelieved liability is carried forward for up to five years to be paid out of future residual profits.

Relief may be granted in one of four potential ways: as a direct payment; a refundable tax credit; a non-refundable tax credit; or a deduction. In order to avoid multiple claims with respect to multiple counterparties the MNE is expected to establish a “Designated Payment Entity” (DPE) which will act as a clearing house such that a single, consolidated, liability will be specified between the DPE and each relieving entity.

Observation: Whilst there is little new here, it is worth noting that the MLC allows the entitlement to Amount A to be carried forward where insufficient relieving capacity exists, but there does not appear to be an equivalent mechanism in the primary Amount A calculation which carries forward any “shortfall” where a group earns less than 10% profit in a particular year. This was a key topic in earlier consultations, but the MLC is silent on this point and there is only a potential average profitability test over up to four years in some circumstances. Again, however, the complexity of this provision cannot be overstated, and its administrability and long-term stability might be questioned.

Step 5: File, pay, and access to tax certainty

Bilateral double tax treaties are to be superseded to the extent necessary to apply Amount A.

The OECD’s Understanding on the Application of Certainty for Amount A of Pillar One (UAC) is an important step in encouraging MNEs and jurisdictions to see an administrative advantage in Amount A - a matter that is now further

clarified. An MNE will potentially receive binding multilateral certainty via three mechanisms (advance certainty, scope certainty, and comprehensive certainty) about being out-of-scope or, if it is in-scope, about its proposed methodology and its overall application of rules. For material issues related to Amount A - a transfer pricing, business profit, or withholding tax characterisation dispute covered by a tax treaty - access to the Mutual Agreement Procedure (MAP) should be guaranteed and a solution implemented. Where there is no timely resolution and no alternative mandatory resolution mechanism is available, the issues will be escalated to one of the new dispute panels.

Observation: The introduction of a binding dispute resolution mechanism to resolve issues which are “related” to Amount A, including material underlying transfer pricing issues is an important new feature. It is mandatory for OECD and G20 members and remains elective for low and middle income countries.

DSTs and relevant similar measures

The MLC mandates the removal of existing DSTs for all companies along with a pledge not to introduce such measures in the future. A list of existing measures which must be removed is in Annex A of the MLC; it includes nine measures in eight countries: one in Asia (India), one in Northern Africa (Tunisia), and six in Europe where DSTs were first applied (Austria, France, Italy, Spain, Turkey, and the United Kingdom). Furthermore, it demands a commitment to refrain from applying Significant Economic Presence (or similar nexus) criteria to MNEs within its scope, a concept that has been championed by a few developing and emerging economies.

The CoP is also empowered to make determinations as to whether a measure is a subnational DST or relevant similar measure. If a DST or relevant similar measure has been identified at a subnational level, there is no denial of Amount A for the party in which the subnational entity is located. However, the party will have to report in detail to the CoP on its best efforts to remove the measure, within six months from the decision of the CoP. The preamble to the MLC notes that parties to the MLC must use their best efforts, consistent with their constitutional order, to prevent such measures being adopted at the subnational level.

Observation: If a final Amount A MLC can be agreed to and signed by a critical mass of jurisdictions by the end of 2023, it is very likely the current standstill on DSTs (in place through the end of 2023) can be extended through 2024, and potentially 2025 if needed. Canada, which did not sign on to the OECD’s [July 2023 Outcome Statement](#), remains set to introduce a DST for 2024. It will be critical to come to a resolution with Canada (in particular with the United States), to move the Amount A MLC forward.

Process of implementation

Signature of the MLC will be followed by ratification, acceptance or approval by jurisdictions. The appropriate term will depend on domestic legal requirements. Once the domestic procedures have been completed, an instrument of ratification, acceptance or approval will be deposited with the OECD, the depositary.

The Amount A MLC will enter into force once two conditions are met: (1) the deposit of the thirtieth instrument of ratification, acceptance or approval with the OECD; and (2) the deposit of instruments of ratification, acceptance or approval by jurisdictions representing a total of 600 points or more as attributed in the 999 points allocated in Annex I (e.g., the United States has 486 points attributed to it). Within three months of these two items being completed, the signing jurisdictions will meet with the OECD to decide when to bring the MLC into force, and will take into account available relief for double taxation, diversity of jurisdictions signing, and the magnitude of global GDP represented. These meetings will happen every six months until the entry into force date is decided.

In most cases, the earliest possible entry into effect date is the first day of the next calendar year following the date which is six months after the date on which the MLC enters into force for a party. In the case where at least one of

the group entities of an MNE has been subject to a DST or similar measure (listed in Annex A) in the calendar year immediately prior to the calendar year previously described, the MLC will enter into effect on the first day of that calendar year.

Observation: As can be seen from the numerical requirements above, the MLC cannot come into force if the United States does not ratify. This puts a spotlight on whether the US administration will sign, and the US Senate would then ratify, the MLC.

The path forward

Amount A of Pillar One will likely be preceded by other elements of the two pillar solution. Notably absent from this package was any further guidance on Amount B (i.e., transfer pricing for routine distribution and marketing transactions), which the IF continues to work on, post-consultation, to provide final guidance by the early part of 2024.

Consultation history

The OECD previously released nine consultation documents on Amount A. Separate responses were requested in relation to each consultation document. The first release covered the [revenue sourcing and nexus rules](#), the second release covered the rules for [tax base determinations](#), the third release covered the [general scope rules](#), the fourth release covered the [exclusion for extractive industries](#), the fifth release covered the [exclusion for regulated financial services](#), and the sixth and seventh covered [tax certainty](#). The eighth covered [guidance on unilateral measures](#), and the ninth covered [administration and tax certainty aspects](#). While there have been developments in many of these areas, it is again important to note that some significant issues remain, and many of the rules remain very complex.

Let's talk

For a deeper discussion of how Amount A might affect your business, please contact:

Tax policy leadership

Will Morris, *Washington*
+1 202 213 2372
william.h.morris@pwc.com

Edwin Visser, *Amsterdam*
+31 0 88 7923 611
edwin.visser@pwc.com

Tax policy contributors

Kartikeya Singh, *United States*
+1 (202) 312 7968
kartikeya.singh@pwc.com

Giorgia Maffini, *United Kingdom*
+44 (0) 7483 378 124
giorgia.maffini@pwc.com

Stewart Brant, *United States*
+1 (415) 328 7455
stewart.brant@pwc.com

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