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Sent via email: tfde@oecd.org

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**Subject: Comments on Progress Report on Amount A of Pillar One**

BDO is one of the largest full-service audit, tax and advisory organisations in the world. We employ over 97,000 people in over 1,700 offices in 167 countries and territories. Our global organisation focuses on supporting entrepreneurially spirited, ambitious businesses.

We appreciate the opportunity to submit our comments on the public consultation document **"Progress Report on Amount A of Pillar One" (**Progress Report) that was released by the OECD on 11 July 2022 and to provide our input on the OECD's ongoing work in respect of this important tax policy matter.

Our comments on earlier OECD public consultation documents on the building blocks of Pillar One centered on several key points, some of which remain relevant to the current Progress Report:

- **Accuracy v. Practicality** – The Pillar One rules must strike the right balance between accuracy and practicality. They must be administrable by MNE taxpayers, and the results must be verifiable by the tax authorities. More detailed rules with more complexity may, at the margin, result in more accurate allocations, but that enhanced accuracy may come at a steep price. We provide comments on striking the balance between accuracy and practicality.
- **Enhanced Clarity –** Many of the proposed rules would benefit from greater specificity. For example, some aspects of the rules for the determination of taxable profit and the rules for the elimination of double taxation lack the necessary precision to provide clear guidance.
- **The Tax Certainty Process** – The administration and tax certainty process guidance will be critically important to the effective implementation of Amount A of Pillar One.

Overall, we continue to believe that easing, rather than increasing, the compliance burden and uncertainty for taxpayers is of paramount importance as tax authorities across the globe address issues related to the digitalization of the economy. These overarching principles should be reflected in the design and implementation of the new rules.

Our comments, developed by a BDO global working party, are set out in detail below. We hope they will be of assistance to the OECD and the Task Force on the Digital Economy (TFDE). If you

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have any questions or would like any further detail, please do not hesitate to contact us. We look forward to working with you and supporting you as you continue your work in this area.

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**COMMENTS ON OECD**
**PROGRESS REPORT ON AMOUNT A OF PILLAR ONE**

**Title 1: Scope**

Title 1 of the substantive rules on Amount A defines the Covered Groups whose profits may be subject to a tax charge under Title 2. Title 2, in turn, contains the charging provisions that would allow a market jurisdiction to apply the new taxing rights to one or more entities of the Covered Group.

The proposed scope rules seem generally straightforward. However, a few provisions would benefit from additional clarity.

Under Title 7 (Definitions), the term "Acceptable Financial Accounting Standards" is defined as:

> IFRS and the GAAP of: Australia; Brazil; Canada; Member States of the European Union; Member States of the European Economic Area; Hong Kong, China; Japan; Mexico; New Zealand; the People's Republic of China; the Republic of India; the Republic of Korea; Russia, Singapore; Switzerland; the United Kingdom; and the United States of America.

This definition does not address circumstances in which a Covered Group does not maintain its financial records according to either of these standards, or when results may differ under International Financial Reporting Standards (IFRS) or Generally Accepted Accounting Principles (GAAP).

Article 1(2) of the Progress Report provides that a "Covered Group" must satisfy the "revenue test" and the "profitability test" for Pillar One Amount A to apply. The revenue test defines "Revenues of the Group for a Period" as "the revenues reported in the Consolidated Financial Statements of the Group for the Period prepared in accordance with an Acceptable Financial Accounting Standard."

Similarly, the profitability test requires the calculation of the "Pre-Tax Profit Margin of the Group for a Period" using "Revenues of the Group for the Period" and "the Financial Accounting Profit (or Loss) of the Group for the Period" as reported in the "Consolidated Financial Statements," which are prepared "in accordance with an Acceptable Financial Accounting Standard."

The accounting standards by which "Revenues of a Group" and "Financial Accounting Profit (or Loss) of the Group" are measured are defined by the accounting standards in a limited number of jurisdictions. We suggest that the Task Force on the Digital Economy (TFDE) consider the impact on a Covered Group that includes entities resident in tax jurisdictions that are not listed in Title 7(7) of the OECD Progress Report, which may use local accounting standards that do not conform with IFRS or GAAP. How would this be factored into the calculation of Amount A?

Financial information prepared in accordance with either IFRS or GAAP is acceptable when determining whether a Group is subject to Amount A. We suggest that the TFDE consider a scenario whereby differences in the accounting treatment of "Financial Accounting Profit (or Loss)"

between IFRS and GAAP may result in a Group qualifying for “Amount A” under one accounting standard, but not the other.

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

While the revenue sourcing rules in the Progress Report remain relatively unchanged from the draft model rules in the February 2022 consultation document, some welcome changes have been made. However, further changes would help achieve the goal of balancing the need for accuracy with the need to limit compliance costs.

For example, while we are heartened to see that the initially proposed transaction-by-transaction approach to revenue sourcing is absent from the Progress Report, this unfortunately has not resulted in a significant simplification of the revenue sourcing rules. However, the Progress Report does introduce the concept of an “initial transition phase” during which Covered Groups would be allowed to source their revenue using several allocation keys without the need to fulfil the requirements under Section 2(6) of Schedule E, which essentially requires the Covered Group to demonstrate that it has taken “reasonable steps” to identify an Enumerated Reliable Indicator, and has concluded that no such Enumerated Reliable Indicator is available. However, after the three-year transition period, MNEs would be required to source all products, services, and use of intangible property to end-users. This directive includes transactions involving components, intermediate products, and intangible property transactions associated with them. While allocation keys are available for this sourcing exercise, they may be used only after administrative hurdles have been cleared.

We continue to advocate for a broader adoption of allocation keys, without the administrative burden associated with their use. More specifically, we would encourage the TFDE to consider adopting the approach to revenue sourcing embodied in the initial transition phase and make that approach a permanent option. A reasonable allocation key should be sufficient and preferable to what may turn out to be a difficult and unsuccessful search for data for many MNEs, especially those outside of the digital economy.

As a secondary approach, we suggest that the revenue sourcing rules proposed for the specific transaction types in the Progress Report could be applied if an MNE wanted to do so and could demonstrate that the approach would yield a Reliable Indicator. But we continue to believe that the primary methodology should be the use of an allocation key. Under this approach, an MNE would not have to search for data within or outside its group in order to allocate revenue, nor would it have to demonstrate that it tried but failed to identify a Reliable Indicator. We believe this approach would greatly simplify the implementation of Pillar One.

The Progress Report introduced another change to the version of the draft model rules presented in the February 2022 consultation document. In addition to the Enumerated Reliable Indicators and Another Reliable Indicator, the progress report provides a new “Alternative Reliable Indicator” that Covered Groups may use for revenue sourcing purposes. However, in order to avail itself of this new type of indicator, a Covered Group would have to provide documentation to the “Review Panel in the Advance Certainty Review” to explain the reasons for using the Alternative Reliable Indicator.

While the motivation behind the introduction of the Alternative Reliable Indicator concept is well intentioned, trying to provide MNEs additional flexibility in applying the revenue sourcing rules, in practice the end result may be an increased administrative burden.

**Title 4: Determination and allocation of taxable profit**

Title 4 contains the rules for determining and allocating taxable profit. Article 5 of Title 4 sets out the steps for determining a Covered Group's adjusted profit before tax, and in paragraph 1 of Article 5, "Adjusted Profit Before Tax for a Period" is defined as the "Financial Accounting Profit (or Loss) of a Covered Group after making the adjustments set out in paragraph 2 and deducting any Net Losses in accordance with paragraph 3."

Our understanding is that the starting point for the determination of adjusted profit before tax of a group will be profit determined in accordance with IFRS and (or) the GAAP of certain countries for the year. Based on the wording of paragraphs 1, 2 and 3 of Article 5, we would expect that the starting point is Net Income (Loss) as presented in an MNE's Consolidated Financial Statements prepared in accordance with IFRS and GAAP, but this starting point should be made clear in the rules.

Under paragraph 2 of Article 5, the Covered Group's Financial Accounting Profit (or Loss) for a Period is subject to several book-to-tax adjustments. It appears that in each case, these adjustments are to be derived directly from information available on the Covered Group's Consolidated Financial Statements. If, however, the information is not available there, would a Covered Group be required to compile the information from other sources? Would these items need to be tracked separately from the Consolidated Financial Statements? If so, the rules should clearly specify this.

Paragraph 3 of Article 5 addresses the treatment of Net Losses of a Covered Group. For purposes of deducting Net Losses as specified in paragraph 1, losses transferred in an Eligible Business Combination or Eligible Division are determined in accordance with rules specified in Schedule H of the Progress Report. It appears that these amounts will have to be calculated and tracked separately from the Consolidated Financial Statements. In addition, the rules for deductibility and the use of an alternative allocation factor are quite complex, the latter seeming to require approval through the still-undeveloped certainty panel process.

Taxpayers require clarity with respect to the determination of their tax liability under Pillar One. Given the variations in the definition of certain terms under various forms of GAAP and/or under various countries' local tax legislation and regulations, the TFDE should provide clear definitions of each term used in the calculation of Adjusted Profit Before Tax of a Covered Group.

In addition, to reduce the overall tax compliance burden for Covered Groups, all the adjustments to be made under paragraph 2 and the application of losses under paragraph 3 should be based on amounts that are readily available in the Consolidated Financial Statements and/or the Notes to the Consolidated Financial Statements for the Covered Group. No adjustments used in the determination of Adjusted Profit Before Tax should require separate tracking from the Consolidated Financial Statements or the Notes to the Consolidated Financial Statements.

Article 6 of Title 4 contains the formulas for the allocation of profit to market jurisdictions (paragraph 2) and for calculating the marketing and distribution safe harbour (MDSH) (paragraph 3). The formula for the allocation of profit to market jurisdictions reflects the mechanism set forth in the Progress Report and is straightforward. However, the MDSH mechanism as it is currently stated in paragraph 5 is overly complex, and in some aspects, unclear.

We understand that aspects of the MDSH are still being discussed. As the TFDE continues to develop this mechanism, stakeholders would benefit from specificity and examples. Alternatively, the mechanism could be reconfigured to more clearly reflect its intent as a safe harbour.

Specific instances where greater clarity is needed include, for example, the reasoning behind the 40% used in the PEP definition, and the use of Y, an offset percentage. Furthermore, as footnote 3 correctly states, the approach based on payroll and asset bases might lead to inappropriate outcomes for certain types of (functional) entities.

We would welcome a simplified approach, perhaps exclusively based on the relation between the local profit margin and the profit margin of the group. For example, the safe harbour could apply if the local profit margin is equal or higher than the group profit margin, or at least a certain percentage of that group margin. Alternatively, certain fixed routine margins could be set as safe harbours, or a combination of margin and depreciation and payroll costs. Another simple approach would be to deduct the actual local profit margin (or a multiple) from Q (initial Amount A allocation) as a safe harbour.

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

The description of the method to allocate the Amount A profit from relieving jurisdictions is complex and open to multiple interpretations in several areas. Comprehension could be significantly aided by providing examples of how taxpayers should apply the relieving methodology.

Specifically, some consideration should be given to how loss-making jurisdictions are treated in computing the group of jurisdictions as specified in Article 8,1(a). If, for example, 80% of jurisdictions are profitable with aggregate profits of 1,200, and 20% of jurisdictions are loss making with aggregate losses of 200 (resulting in total group Elimination Profit of 1,000), then the formula as stated will produce only jurisdictions with aggregate profits of 950, potentially leaving a larger portion of profitable jurisdictions out of the pool than the remaining 5% of aggregate profits.

Similarly, if entities are carrying forward losses from previous years per the computation of Elimination Profit, then there may be a material mismatch between profitability per the country-by-country report and the Elimination Profit formula. This is the case because the country-by-country report reflects only current-year financial results and does not take into account carry-forward losses.

Article 9 of Title 5 contains the allocation formulae for the obligation to eliminate double taxation with respect to Amount A. It is structured as a “waterfall,” with different tiers of jurisdictions required to eliminate the Amount A double taxation in turn. In general, these tiers

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are based on a comparison between the “Return on Payroll and Depreciation for a Covered Group with respect to a Jurisdiction” and the Return on Payroll and Depreciation of the Covered Group. However, the rules set forth in the Progress Report do not specifically define the latter term; as a result, there could be confusion as to how to calculate it, in particular with respect to the denominator (Payroll and Depreciation of the Covered Group).

Tier 1 jurisdictions are those where the return on depreciation and payroll is greater than 1500% of the aggregate return (or 15 times the aggregate return) for the Covered Group as a whole. Placing the entirety of the burden of relieving tax on the Tier 1 jurisdictions (until they reach a return on payroll and depreciation equal to 1500% of the return of the group) appears overly burdensome on the Tier 1 jurisdictions. Furthermore, this may result in some unintended consequences that would benefit the economies of Tier 1 jurisdictions to the detriment of other jurisdictions (most prominently low labour cost jurisdictions).

For instance, as taxing rights are reallocated from Tier 1 jurisdictions until the point that they meet the 1500% threshold, and there is no requirement for the substance of the Depreciation and Payroll expenses to be of a particular quality, then, for example, one method of reducing the amount of taxing rights to be reallocated from a Tier 1 jurisdiction could be to increase that jurisdiction’s payroll expenses. This could be to the detriment of low labour cost economies that host routine shared services or back-office operations.

Moving these operations to the Tier 1 jurisdiction would result in lowering that jurisdiction’s Return on Depreciation and Payroll. As a result, it would also reduce the allocation of taxing rights away from the Tier 1 country, to the extent that the reduced tax could sufficiently offset the increased cost of employing personnel in the Tier 1 jurisdiction. By placing all of the initial burden on the Tier 1 jurisdictions, the impact of relocating employees away from low labour cost economies becomes counterintuitively beneficial, with the low labour cost economies ultimately bearing the negative consequences through lower employment and foreign direct investment.

A potential solution would be to reduce the burden on the Tier 1 jurisdictions so that the incentive to relocate routine functions away from low-cost economies to Tier 1 countries is diminished.

When Tier 1 jurisdictions have exhausted their capacity to allocate taxing rights, Tier 2 applies. Tier 2 jurisdictions have an adjusted return on depreciation and payroll of over 150% (1.5 times) of that of the Covered Group as a whole. The reallocation mechanism works the same way as it does for Tier 1 jurisdictions, but it is not clear if a Tier 1 jurisdiction becomes a Tier 2 jurisdiction following the exhaustion of the allocation of taxing rights under Tier 1. Furthermore, Tier 2 Residual Profit is not defined, and as such, is ambiguous.

**Title 6: Administration**

The Progress Report defers discussion of administration and tax certainty to a separate document to be released by October 2022. The complexity of the rules and potential disparities in the implementation of Amount A by tax jurisdictions around the world may lead to an increase in disputes over taxing rights between jurisdictions. Jurisdictional implementation differences may result in a greater risk of inconsistent approaches and double taxation, which in turn may

increase pressure on the tax certainty process. Therefore, the rules related to administration and tax certainty are critically important, and we look forward to the opportunity to comment on them.