

Progress Report on Amount A of Pillar One

Frequently asked questions

JULY 2022

1. How will the Amount A rules help to stabilise the international tax system?

Pillar One Amount A rules apply to the biggest and most profitable MNEs and allocate parts of their profits to the countries where they sell their products and provide their services (the market countries). Any such allocation is capped or eliminated, however, where the market country already exercises taxation over the MNE's residual profits under the marketing and distribution profits safe harbour (see question 8).

One of the key objectives of this new taxing right is to restore stability to the international tax framework and prevent further uncoordinated unilateral tax measures, as a multilaterally agreed solution will avoid the risk of retaliatory trade sanctions that could result from unilateral approaches such as digital services taxes. Also, a central element of Amount A is an innovative Tax Certainty Framework for Amount A disputes which guarantees certainty for in-scope groups over all aspects of the new rules, including the elimination of double taxation (see question 9). Furthermore, a tax certainty process for issues related to Amount A will ensure that in-scope Groups will benefit from dispute prevention and resolution mechanisms to avoid double taxation due to issues related to Amount A (e.g. transfer pricing and business profits disputes), in a mandatory and binding manner. Finally, in order to further secure the stability of the international tax framework, the implementation of Amount A will include a commitment to remove Digital Services Taxes and other relevant similar measures, and to commit not to adopt such measures in the future.

2. Has the Inclusive Framework consulted with business and other stakeholders on designing the Amount A rules?

Stakeholder input plays an important role in the development of the Amount A rules. The Inclusive Framework has engaged with businesses, NGOs, academics, and other stakeholders throughout the development of Amount A through various public consultations. Initially, two public consultations were held in 2019 to gather stakeholder input on the general design of Pillar One. Based on the input received and further work by the Inclusive Framework, the Blueprint on Pillar One was released in October 2020 to outline the different components of Pillar One. Subsequently, a third public consultation took place in early 2021 to discuss the Blueprint. The input provided by stakeholders during these consultations has informed the discussions in the Inclusive Framework and has shaped the agreement on the key components of Amount A as reflected in the Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, released in October 2021. Since the release of the Statement, the Inclusive Framework has been developing the technical rules for Amount A and, as part of this process, has organised public consultations on a rolling basis to seek public input on the design of specific "building blocks" of Amount A. Since January 2022, more than 250 stakeholders have provided input on seven different building blocks. The release of the Progress Report on Amount A of Pillar One in July 2022 marks another important step in consulting stakeholders to seek input on the key components and technical rules of Amount A. The input received will aid the Inclusive Framework in refining and finalising the Amount A rules.

3. Which MNEs are in scope of the Amount A rules?

Amount A is based on a comprehensive scope that uses quantitative thresholds to determine whether an MNE is subject to the rules on Amount A. This means that any MNE that meets the scope thresholds will have to apply the Amount A rules, regardless of what type of business it undertakes (subject to

targeted exclusions described in question 4). The quantitative scope thresholds have been designed to operate in an objective and easily administrable way. Under the scope thresholds, MNEs with revenues greater than EUR 20 billion and with profitability greater than 10% will be in scope of Amount A. These thresholds apply at a group level (i.e. to the entire MNE), using the financial data in an MNE's consolidated financial statements. In exceptional cases where an MNE does not meet the profitability threshold, but a segment reported in the MNE's consolidated financial statements (a 'Disclosed Segment') has revenues greater than EUR 20 billion and profitability greater than 10% on a standalone basis, that Disclosed Segment will be in scope of Amount A (see question 10).

These quantitative thresholds provide neutrality in the application of Amount A rules, but also create potential compliance issues for MNEs with volatile profitability which could fall in and out of scope from one year to another. To address this issue and bring stability to the scope of Amount A, the profitability threshold includes an averaging mechanism whereby any MNE is required to meet the 10% threshold on average across five years (the current year and four prior years) and, also, in two out of the four prior years. This mechanism applies to all MNEs that have not been in scope before or, have been in scope previously, but not in the two immediately preceding years.

The revenue threshold is expected to be reduced to EUR 10 billion over time, provided the system is operating as intended (including on tax certainty), with the relevant review beginning 7 years after Amount A comes into force.

4. Why do the Amount A rules provide exclusions for things like mining companies and regulated financial services?

The exclusion for mining, oil and gas companies does not seek to provide benefits to certain MNEs; rather, it is about protecting the right of source countries to have the sole right to levy tax on those profits related to the extraction of valuable resources that uniquely belong to the people of that country. The exclusion for Regulated Financial Services recognises the unique nature of regulation of that industry (particularly capital requirements) that already drives substantial alignment between the location of taxable profits and the market, as well as the unique complexity and cost that would be introduced for tax administrations to administer the complex rules necessary to make Amount A fit for purpose for that industry.

To apply the exclusions for Extractives and Regulated Financial Services in practice, separate rules have been designed to describe how MNEs (or their 'Disclosed Segments', as explained in question 10) should separate excluded revenues and profits from those that are covered by Amount A. Generally, the exclusions are applied using a predominance test which examines whether 75% of the revenues are related to activities excluded from Amount A (either at the level of an entity or, in some cases, a Disclosed Segment). Where the 75% excluded revenue test is not met, the exclusion is applied by removing the revenues and associated costs that are related to activities that are not in scope of Amount A, in order to recalculate the remaining revenue and profit of the MNE.

5. When are market countries entitled to tax Amount A profit?

The Amount A rules allocate profits to market countries where an MNE does business (even without physical presence). This means that market countries that should benefit from Amount A are not necessarily those in which revenues are booked (typically through a local subsidiary), but rather those where the end-users of goods or services are located. Specific revenue sourcing rules provide a common basis for identifying an MNE's market countries that will benefit from Amount A, categorised per type of revenue. For revenues from online advertising, for example, the sourcing principle is based on the "eye-balls" of the viewer, and not on the location of the advertiser. To identify the viewer, the MNE should use data points that reliably indicate the location of the viewer, such as IP address or geolocation, or other reliable commercial information.

In some cases, it will be very challenging for an MNE to locate the end-user. This may be the case, for example, for revenues from cloud computing services, where the MNE may not have information

available on where its customer's employees use the service. In order to provide for certainty in these more challenging cases, the MNE is allowed to use targeted proxies or allocation keys, which approximate the market country (such as allocation keys based on statistical information on aggregated headcount data or macro-economic proxies). This is a way to balance the compliance burden, while ensuring that Amount A profits are reliably reallocated in all cases.

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 new quantitative special purpose nexus test. This test is satisfied when an MNE generates more than EUR 1 million in revenues in a market country (as determined under the revenue sourcing rules). To ensure that smaller countries will benefit as well from the new rules, a lower nexus threshold of EUR 250 000 applies where a country's GDP is lower than EUR 40 billion. These thresholds have been designed to limit the compliance costs for taxpayers and tax administrations, and ensure that the nexus test is only satisfied where the amount of revenue the MNE derives from a country is material.

6. How are the MNE's profits calculated for the purposes of this new taxing right?

Since Amount A allocates a portion of the global residual profits of the MNE, it is necessary to establish a measure of profit for the whole group for Amount A to apply. This is the purpose of the "allocation tax base", which is determined based on the net financial accounting income of the MNE based on consolidated financial accounts prepared in accordance with IFRS, US GAPP or an equivalent financial accounting standard. To avoid complexity, only a limited number of book-to-tax adjustments are required, such as the deduction of certain items of income and the adding back of certain expenses. These adjustments seek to address specific policy considerations. For example, Excluded Dividend and Equity Gain or Loss adjustments are intended to ensure that relevant profits are not included in the allocation tax base of more than one MNE. Further, the Tax Expense (or Tax Income) adjustment ensures that the pool of profit subject to re-allocation under Amount A is not reduced by taxing rights exercised by one or more countries under existing tax rules.

Separately, for the purpose of identifying the countries that will be obliged to eliminate double taxation (see question 9), another measure of profit of the MNE needs to be calculated under Amount A at the level of each relevant country. This is the purpose of the "elimination tax base" which, unlike the allocation tax base, is determined for a country only based on the sum of the net financial accounting profit or loss of each entity located in that country. This elimination tax base uses the same accounting standards as the allocation tax base, and is generally subject to the same book-to-tax adjustments, with only some additional adjustments typically aimed at ensuring a closer alignment with existing domestic corporate income tax rules. For example, income adjustments are adopted where taxing rights may be exercised by a country other than the residence country of the entity recording relevant income or expenses for accounting purposes, such as in the case of permanent establishments (which are taxable in the source country) and flow through entities (which are taxable in the hands of the shareholders).

To simplify compliance, these adjustments generally follow the rules and practices that have already been developed for the GloBE jurisdictional tax base computation.

7. How are losses of MNEs taken into consideration?

To ensure an appropriate measure of the profit of an MNE under Amount A, the rules also provide for a loss carry forward regime. This regime is based on an earn-out mechanism designed to ensure, subject to certain time limitations, that no Amount A profit is reallocated until the historic losses of the MNE have been absorbed. Consistent with the other features of Amount A, this carry-forward regime applies at the group level and needs to be administered separately from any existing domestic loss carry-forward regime applicable to the MNE entities.

In some cases, an MNE also has the option to recognise the historic losses incurred by another business that has since become a part of that MNE, as a result of a business combination or a division. Specific

rules and conditions apply to ensure that such losses transferred to the MNE do not give rise to double counting of losses or artificial arrangements (so-called loss trafficking).

The time limitations that can limit loss carry-forward in some cases are two-fold. The first aspect is purely a transitional rule and provides that only losses incurred within the three calendar years preceding the implementation of Amount A ("pre-implementation losses") are available for deduction and carry-forward. The second aspect is for general application, and provides that losses cannot be carried-forward for more than ten calendar years for Amount A purposes.

8. What is the Marketing and Distribution Profits Safe Harbour?

The marketing and distribution profits safe harbour (MDSH) is primarily designed to address issues related to 'double counting'. For example, this may occur if a market country has the ability to tax residual profits of an MNE in two ways: once under existing profit allocation rules (typically transfer pricing), and again through Amount A allocations. To prevent this, in circumstances where a market country already has taxing rights over an MNE's residual profit, an additional step is included in the calculation of Amount A to reduce the profit reallocated to that country by the amount of residual profit already taxed there. Effectively, this works as a capping mechanism on Amount A allocations.

To avoid complexity and to remain consistent with other features of Amount A, this capping mechanism follows the same jurisdictional and quantitative approach also used in connection with the elimination of double taxation (see question 9). This includes a formula to determine the precise amount of the reduction for each market country (where applicable), and quantitative criteria to identify residual profits already taxed in a market country (such as a Return on Depreciation and Payroll). Several aspects of the rule design, including specific metrics to identify residual profits in a market country, the portion of that residual profits that will offset (and reduce) Amount A allocations, and the interaction of this adjustment with the elimination of double taxation mechanism (see question 9) are still under development.

9. How is the obligation to relieve double taxation allocated among countries?

The obligation to eliminate double taxation which would otherwise be suffered by an MNE with respect to Amount A will be allocated among countries using a quantitative approach designed to ensure that the obligation is borne by the countries in which the MNE earns its residual profits. Those countries will be divided into tiers based on the MNE's profitability (measured by reference to Return on Depreciation and Payroll, or "RODP") in each country relative to the overall profitability of the MNE, and double taxation would first be relieved by countries identified in the highest profit tiers. As such, double taxation is eliminated first by countries in Tier 1 (those with an RODP exceeding 15 times the overall MNE's RODP) using a "waterfall" approach according to which the country with the highest RODP relieves double taxation on the amount of profit would reduce its RODP until it is equal to the RODP of the country with the second highest RODP. These two countries then relieve double taxation on an amount of profit that would reduce their RODP until it is equal to the RODP of the country with the third highest RODP. This process continues until either the obligation to relieve double taxation with respect to the Amount A profit of the MNE has been fully allocated, or the RODP of countries in Tier 1 has been reduced to 15 times the RODP of the MNE.

To the extent that double taxation is not fully relieved from Tier 1 profits, countries with greater than 1.5 times the overall MNE's RODP (referred to as Tier 2) would be required to relieve double taxation in proportion to their percentage of the total MNE's profits within that tier until either the obligation to relieve double taxation with respect to the Amount A profit of the MNE has been fully allocated, or the profits within Tier 2 are exhausted. After that, the obligation to relieve double taxation would be divided among all remaining countries considered to have residual profits, starting with those with relatively higher returns (greater than 40% RODP, referred to as Tier 3A) first, before moving, if necessary, to any other countries with residual profits (greater than RODP that is equivalent to a 10% return on revenue for the Covered Group, referred to as Tier 3B). Countries with no residual profit within any of these tiers will not be required to relieve double taxation arising from Amount A.

Once the obligation to eliminate double taxation is allocated to one or more countries, specific rules will also govern the identification of the MNE entities in these countries that will be entitled to relief from double taxation, as well as addressing the methods by which relief will be provided.

10. How do the Amount A rules apply to a segment?

As explained in question 6, the Amount A rules take an innovative approach to the taxation of an MNE's profits as they apply at a group level (i.e. to the entire MNE) rather than at an entity level. However, the Amount A rules may, in limited circumstances, apply to a segment that is reported in an MNE's consolidated accounts (a 'Disclosed Segment') instead of to the MNE as a whole. These rules will apply in exceptional circumstances where an MNE with more than EUR 20 billion of revenues does not meet the 10% profitability scope requirement, but a Disclosed Segment of that MNE meets both the EUR 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. Accordingly, the Amount A rules will be adapted to apply to a Disclosed Segment, including making limited adjustments to the reported financial information to ensure equitable treatment and adapting the application of the Marketing and Distribution Profits Safe Harbour and the elimination of double taxation mechanism to be applied in the context of a Disclosed Segment.

11. What are next steps for Amount A?

Since the release of the Statement in October 2021, the Inclusive Framework mandated the Task Force on Digital Economy (TFDE) to advance the technical work, and significant progress has been made with respect to various building blocks of Amount A. To ensure that the rules are designed properly and will be administrable for taxpayers and tax administrations alike, the Inclusive Framework decided to seek public input on a consolidated version of the draft rules developed so far. The rules on the streamlined administration process including the tax certainty processes that will form a part of Amount A, will be released in a separate report. The feedback received from stakeholders will be considered by the Inclusive Framework in its' work to refine and finalise the rules on Amount A. Once stabilised, the rules will be translated into provisions for inclusion in a Multilateral Convention ("MLC"), to be signed and ratified by Inclusive Framework members. The MLC will establish the legal obligations of the parties to implement Amount A in a co-ordinated and consistent manner, and will be opened for signature in the first half of 2023, with a view of it entering into effect in 2024, after a critical mass of countries have ratified it.

12. What type of support is planned for developing countries during the implementation phase?

The OECD has a comprehensive programme of capacity building support for developing countries and has supported them consistently in their participation in the Inclusive Framework and in the implementation of the international tax standards since its inception. The Amount A rules are no different, and as the work turns towards developing the rules and instruments needed to implement and incorporate them into law, then the OECD will be ready to support developing countries throughout this process. This support will be provided in close co-operation with regional tax organisations such as the African Tax Administration Forum (ATAF), the Inter-American Center of Tax Administrations (CIAT), the Intra-European Organisation of Tax Administrations (IOTA) and the Study Group on Asian Tax Administration and Research (SGATAR), as well as key development partners like the Asian Development Bank (ADB) and members of the Platform for Collaboration on Tax (PCT) and donor countries that provide resources and expertise. The OECD already started this in 2022 through a series of regional consultations and by developing training seminars and virtual resources. The OECD is also preparing a programme of detailed assistance on how developing countries should analyse the impact of the global minimum tax on their domestic tax incentives and the possibility of applying their own domestic taxes to collect revenue that would otherwise be collected elsewhere as a result of the new

rules. Work to support implementation of the international standard for VAT on e-commerce, which is complementary to the work on Amount A, is also on-going and a priority area for developing countries. These efforts will continue to evolve as the work on the Two-Pillar Solution, including Amount A, is completed and governments start implementing both Pillar One and Pillar Two.