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Pillar One – Amount A: Draft Model Rules for Tax Base Determinations

PwC International Ltd on behalf of its network of member firms (PwC) welcomes the opportunity to share its views in reaction to the above public consultation document. In view of our understanding of the nature and urgency of the request, as well as the limited two-week turnaround, we set out below a brief summary of the issues on which we believe the Task Force and OECD could focus. We would be happy to elaborate on these further or to discuss other matters in the public consultation document.

1. **General points**
   - We note that the document released is a working document from the OECD Secretariat and that it does not reflect the final views of the Inclusive Framework members. Effectively, the output remains subject to final agreement, and by extension, can be subject to change. This makes it somewhat challenging to comment on and to consider in terms of the other building blocks, both released and unreleased. It also makes it difficult to comment in relation to this document since there are numerous references to the Commentaries that will elaborate on or clarify the application of the rules. A key example is the fact that the tax base currently does not account for segmentation for Amount A, notwithstanding that this will be a critical point for many businesses.
   - The document notes that adjustments to be made to the "book" profit "*will be kept to a minimum in order to limit complexity, and align where possible with adjustments under Pillar Two*". This is a welcome and worthwhile objective, however, we note that the adjustments referred to in calculating the tax base for Amount A do not extend in number or effect to those adjustments that will be made in reaching the Pillar Two GloBE tax base. The adjustments should align with the Pillar Two Globe adjustments as much as possible to minimise complexity for taxpayers and the number of alternative sets of accounts that are effectively needed. In addition, any elective method of accounting available to a taxpayer and accounted for under the GloBE rules should also be mirrored in calculating the Pillar One Amount A tax base.

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2. Calculating book-to-tax and restatement adjustments

- **Adjusted Profit Before Tax**

  Article 5(1) of the draft Model Rules suggests that the starting point for calculating the Amount A tax base is the profit before tax per the consolidated financial statements for the covered group. We note that this has been made quite clear in the Pillar One draft model rules, whereas for the Pillar Two GloBE rules, the definition of "Financial Accounting Net Income" is not as prescriptive as it merely refers to "net income or loss". We ask for clarification as to whether the starting point for the GloBE tax base is also expected to refer to the profit before tax for the in-scope constituent entities. This clarification is relevant for taxpayers impacted by both sets of rules, which will have to calculate both an Amount A and a GloBE tax base.

  The following points require specific attention:

  1. Net income should not include income deriving from realised or unrealised gains or losses generated by an ownership interest that is not an entity of the covered group;
  2. A minority share of the income that is included in net income but belongs to the minority shareholder should be excluded; and
  3. Additional guidance is needed for significant financial statement items that may have asymmetric treatment for tax purposes (e.g., stock based compensation, consolidation adjustments, defined pension plans, goodwill in M&A).

- **Book-to-tax adjustments**

  In order to reach the covered group's Adjusted Financial Accounting Profit, a number of adjustments need to be made to the profit before tax.

  The public consultation document suggests that, for ease of administration and compliance, the adjustments to calculate the Adjusted Profit Before Tax for Amount A will be kept to a minimum in order to limit complexity and align where possible with adjustments under Pillar Two. While the Amount A Adjusted Profit Before Tax is intended to resemble the Pillar Two GloBE tax base, the adjustments under both Pillars' base calculations will differ according to the Model Rules for both. There are clearly fewer adjustments outlined in these draft rules than there are for calculating GloBE income (e.g., no adjustments for pension, stock compensation, foreign exchange gain and loss). There is also a very different approach to the utilisation of losses between both sets of rules.

  Note that the draft rules do not address whether or how to account for minority interests in computing the Amount A tax base, nor do the rules address issues around computing the tax base for dual-headed MNE groups that are listed on different exchanges.

  The following are some specific items that require further consideration:

1. Exclusion of gains/losses associated with the disposal of equity interests: We recommend that gains/losses from controlling interests should be excluded, regardless of the form of transaction which gave rise to the gain/loss. We do not believe that there should be one rule for the disposal of equity interests giving rise to a gain/loss and another rule for asset disposals. This may favour equity disposals, which in turn may impact deals where one or both parties would otherwise have managed the deal via an asset sale and acquisition.

2. Section 9 of the draft Model Rules refers to a concept of "joint control". This is in reference to equity gains or losses that are reflected in the covered group's financial statements that are included under the equity method of accounting, apart from profits or losses derived from a Joint Venture in which the Covered Group has "joint control". We ask for further clarification on the meaning of "joint control". Is this to be interpreted as a 50:50 ownership split?

3. Policy disallowed expenses are to be reversed out in calculating the Adjusted Profit Before Tax. This term is also referred to in the GloBE rules and such expenses are required to be adjusted to the extent that they have been booked as part of the Financial Accounting Net Income, although there appear to be some differences including the EUR 50,000 threshold on certain items. More broadly, the meaning of this term remains vague even though it has been specified that such expenses include fines and penalties, kick-backs and bribes. We ask that a clearer definition be issued for such expenses. As an example, fines and penalties may come in many forms - from relatively minor economic penalties, for example, due to late payment of an invoice or late delivery of goods, or they may be more material or derive from specific government sanctions. We expect that policy disallowed expenses would not include the former type of penalties given the administrative burdens associated with identifying and adjusting for them.

4. Certain elections in the computation of GloBE income or loss for Constituent Entities do not appear in the Amount A tax base determination rules. For example, we note the lack of an adjustment for stock-based compensation in calculating the Amount A tax base vis-a-vis the GloBE rules. The Model Rules under Pillar Two allow for an election to substitute the stock-based compensation expense included in financial statements with the amount of stock-based compensation expense allowed as a deduction in computing taxable income. These elections may have the impact of creating additional differences between the tax base under Pillar Two as compared to the tax base under Pillar One.

- **Restatement adjustments**

  The current draft Model Rules propose an applicable cap on the Eligible Restatement Adjustment for the Period, based on 0.5% of revenues. The rules state that the level of the cap will be subject to further analysis to balance competing objectives of simplicity and avoidance of excessive single-year impacts. We advocate that this cap be eliminated to prevent uncommercial outcomes.

3. Accounting for Losses in determining the tax base for Amount A

- **Losses carried forward**

  The rules for calculating the Amount A tax base should permit unlimited carry-forward and utilisation of losses, given that there are no time-based limitations on loss utilisation under the Pillar Two GloBE rules. The loss carry-forward rules should be the same for pre-implementation and post-implementation losses.

  Given that under the Pillar Two rules, losses will be accounted for by way of deferred tax, are there any particular issues that we should be aware of that have not been expressly detailed in the Model Rules?

- **Dealing with Profit Shortfalls**

  We believe that the issue surrounding profit shortfalls (which would be created when a covered group does not exceed the 10% profitability limit, with the shortfall being computed as the profit between 0% and 10%) should be further considered as part of the loss carry forward regime.

4. Dealing with business divisions and combinations

- The ability to deduct losses that transfer between entities via business combinations or divisions appears to unduly limit the deduction of such losses against the Amount A tax base. In addition, determining whether transferred losses arise as a result of both a) an Eligible Business Combination or an Eligible Division, and b) if the Business Continuity Conditions are met, seems to be quite a complex endeavour for businesses to undertake.

  We ask that the process be simplified and that taxpayers can elect to deduct a transferred loss in proportion to the business that transferred in a business combination or division. In most cases, we would expect that losses would follow the entity/ies that generated those losses in full, and that those transferred losses would be accounted for to reflect the economic reality of the business.

  The definition of Business Continuity Conditions might reasonably be expanded to include situations where there is a "bolt on" acquisition of an entity that has not carried on a similar business or the same business as the overall covered group, but where, as a result of the Eligible Business Combination, that entity's enterprise becomes profitable due to increased synergies achieved as part of the new covered group. The current definition is a) overly prescriptive in determining what types of business the losses arose from, and b) limiting from the perspective of the overall covered group being able to pivot to take advantage of new opportunities and business direction in the future.

  The definition of Eligible Business Division should also capture spin-off situations with acknowledgement that losses of the entity that is "spun-out" can be allocated between both parties (subject to an election).

5. Conclusions

- Further opportunities to re-consult on the items addressed in the draft rules on tax base determinations will be needed, as the concepts are further refined and the tax base comes into clearer view as part of the overall Amount A rules.
- Replicating, wherever possible, the same rules for determining the Amount A and GloBE tax bases would greatly assist in reducing taxpayer compliance burdens and ensuring that all stakeholders can more easily and quickly understand their obligations under both sets of new rules.

If you would like to ask for additional information on, or explanation of, any of the points made above please do not hesitate to contact me or one of the individuals set out below.

Yours sincerely,

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