20 April 2022

To: Tax Treaties, Transfer Pricing and Financial Transactions Division
Organisation for Economic Cooperation and Development
Centre for Tax Policy and Administration
2 rue André-Pascal
75775, Paris, Cedex 16, France
Submitted by email: tfde@oecd.org

Re: **OECD Public Consultation Document on Pillar One - Amount A: Draft Model Rules for Domestic Legislation on Scope**

Dear Secretariat,

PwC International Ltd on behalf of its network of member firms (PwC) welcomes the opportunity to share its observations on the above referenced 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 on the Digital Economy (TFDE) and OECD could focus. We would be happy to elaborate on these further or to discuss other matters in the public consultation document.

Our comments below are organised sequentially by paragraph number under Article 1, Title 2, of the draft Model Rules on Scope.

**Covered Groups, Group Entity and commencement date (Title 2 - Article 1, paragraph 1 and paragraph 7)**

Covered Group and Group Entity are defined by reference to a combined financial consolidation test and subject to a specific exclusion for Excluded Entities. We note three specific issues below:

***Qualifying Financial Accounting Standard***

*Different labels are used in Pillar One and Pillar Two for the same definition of Qualifying/Acceptable Financial Accounting Standard.*

Covered Groups are likely to already be subject to a requirement to prepare Consolidated Financial Statements to the extent that they are in scope of the Pillar Two GloBE rules. Article 3.1 of the GloBE rules require Consolidated Financial Statements be prepared according to an "Acceptable Financial Accounting Standard." We highlight the use of two different names under Pillar One and Pillar Two (Qualifying Financial Accounting Standard under Pillar One and Acceptable Financial Accounting Standard under Pillar Two). This may cause confusion for businesses applying both sets of rules.

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***Covered Group***

*Pillar One and Pillar Two have different definitions of "Covered Group" and MNE "Group."*

We also highlight the difference in the definition of a "Covered Group" under Pillar One and an MNE "Group" under Pillar Two and that the same entities may not be treated as part of a "Group" under both sets of rules.

The Pillar Two MNE "Group" is defined as "a collection of Entities that are related through ownership or control such that the assets, liabilities, income, expenses and cash flows of those Entities:

(a) are included in the Consolidated Financial Statements of the Ultimate Parent Entity; or
(b) are excluded from the Consolidated Financial Statements of the Ultimate Parent Entity solely on size or materiality grounds, or on the grounds that the Entity is held for sale."

While the Pillar One "Covered Group" is defined as

"(a) the collection of Group Entities whose assets, liabilities, income, expenses and cash flows are, or would be, included in the Consolidated Financial Statements of a UPE; or
(b) an Entity, other than an Excluded Entity, that is not a part of another Group provided that the Entity satisfies the global revenue test and profitability test in paragraph 2 of Article 1."

We note that the definition of Group under Pillar Two focuses more on the concept of ownership and control when determining which entities are part of the group. This means that entities that are and are not consolidated in the UPEs financial statements as well as excluded entities can be in the MNE Group. The Pillar One definition, by contrast, primarily looks at the entities that have been consolidated for financial statement purposes and non-excluded entities that are not part of another Group. It would seem that the Pillar One definition is narrower than the Pillar Two definition of a Group if we consider the number of entities that could be in the MNE Group due to the application of the "control test" (such as non-excluded entities that are not consolidated but nevertheless are controlled by the UPE or, presumably by extension, control the UPE). We recommend considering how best to ensure that there is no difference between both sets of definitions, which should minimise complexity for taxpayers and administrations.

***Excluded Entities***

*Further clarifications would be helpful in relation to the definition of Excluded Entities.*

The definition of a "Governmental Entity" seems slightly ambiguous, as discussed below:

- The first criterion is that it is "part of or wholly-owned by a government (including any political subdivision or local authority thereof)" - if there are specific circumstances envisaged where an entity is part of a government but not wholly government-owned perhaps those should be stipulated (or guidance provided). To what extent might public-private partnerships (PPPs) or semi-state bodies be considered to be a part of a government?
- The second criterion refers to not carrying on a trade or business. In that respect, the scope of "business" can be very wide (See the case law reviewed in *G E Financial Investments v Revenue &*

*Customs* [2021] UKFTT 210 (TC) [72] to 80]. This could be clarified to say that the trade or business is carried on with a view to profit.

- The second criterion also refers to fulfilling a "government function", the meaning of which is not clear and may vary considerably particularly according to political views. The purpose should perhaps be "exclusively" (compare the definitions of pension fund and non-profit organisation) for governmental functions. Its income and assets should be applied exclusively for that purpose (see the definition of non-profit organisation).
- The second criterion might be better divided into two separate tests between trade/business and government function to make clear that these are part of the cumulative test.

**Total revenues of the group (Title 2 - Article 1, paragraph 2(a))**

*The averaging mechanisms for profitability should apply to revenue as well as profitability.*

There do not appear to be any policy principles that would suggest that the kind of averaging mechanism considered appropriate for the profitability tests should not also be applied to the revenues test. Any argument for simplicity in this regard seems to be outweighed by the need to consider those groups with fluctuating revenues.

This is commensurate with the objective for Amount A to reallocate a level of residual profits earned in the ordinary course of business. We would also expect the definition of revenues and our comments on the tax base to be equally applicable here.

Further, the use of an averaging mechanism for the profitability test (and revenue test) on a rolling basis seems to be more appropriate than an 'entry' only basis. The policy rationale of only having in scope group with a sustainable profit level should be respected given the undue administrative burden of being in scope.

Consideration could also be given to whether groups might have some optionality to apply the tests in the most meaningful manner (interactions with the nexus rules should also be considered). This would be particularly pertinent given that the "look-back" period has already begun, and might alleviate any concerns about retrospectivity of the rules.

Our comments above would apply to an even greater extent when the threshold is lowered from the EUR 20 billion based on the October 2021 agreement (i.e., to EUR 10 billion after a period of eight years).

**Prior period and averaging tests (Title 2 - Article 1, paragraph 2(b))**

*The averaging mechanism should be applied on a rolling basis.*

As described in relation to revenues above, a rolling basis for the application of the absolute test, prior period test and averaging test seems more aligned with the objectives of Pillar One than an entry test.

There is no mention of the 'profit shortfall' approach that was discussed in earlier consultations. Allowing for the offset in determining any residual profit above the 10% in one year for any shortfall in a previous year or years would seem to go further than the averaging basis now proposed and may provide a longer term solution that is also as simple to administer.

**Mergers and demergers (Title 2 - Article 1, paragraph 3)**

*Further clarity is needed in the demerger rules.*

The Pillar Two demerger rules in Article 6.1.1(c) are not entirely clear with regard to which periods are to be considered for scope reasons in years 2-4 because of the lack of definition around "tested" years. Footnote 6 of the consultation document notes that the Amount A "Commentaries will elaborate on the practical application of the prior period test and the average test in the case of either a Group Merger or Group Demerger". We ask that the Secretariat consider how best to introduce the same principle, as appropriate, for both sets of rules and to provide sufficient clarity.

**Anti-fragmentation rule (Title 2 - Article 1, paragraph 5)**

*Clarity is needed around "artificially" criteria.*

It is stated that this rule will only apply where a group artificially bifurcates its holding structure (possibly more than once) in order to inappropriately create more than one Entity that meets the definition of UPE of a Group for Amount A purposes. The scope of this rule is limited to situations in which the UPE of the Group is controlled by an Excluded Entity, Investment Fund or Real Estate Investment Vehicle, so its application may be uncommon. However, there are, as yet, no details on what artificiality criteria might be applied nor on what basis would the fragmentation be determined as inappropriate and how that test would be carried out. While we support the need for potential anti-avoidance measures, it is difficult to comment on their certainty and efficacy without such further information.

We ask that the Secretariat provide clarification as soon as possible regarding the date referred to in Footnote 32. Given the importance of this date to businesses who routinely restructure the group's holding structure and undertake genuine business reorganisations, it is only appropriate that the grandfathering date is clarified. This will provide certainty to taxpayers.

**Disclosed segments (Title 2 - Article 1, [placeholder] paragraph 6)**

*Further information is needed to comment.*

It is stated that the TFDE is currently considering provision for "exceptional scope rules for determining when a disclosed segment" is in scope of Amount A. We reserve consideration of any comments we may have for when more information is available including whether that would sufficiently allow for local market differences or whether an additional 'domestic business exclusion' might be warranted (with appropriate consideration of sourcing rules etc).

**Relevant definitions (Title 9)**

We encourage consistent definitions, where appropriate, across both Pillar One and Pillar Two and, when not possible, we recommend that any deviations are identified and explained in the final Commentary / Explanatory Statement.

With respect to the definition of Joint Venture (JV), there could be a case where a JV is an entity that is a Ultimate Parent Entity (UPE) of a separate MNE Group that is already subject to Amount A. We recommend further consideration be given to ensure that a UPE of a separate MNE Group that is subject to Amount A is excluded from the definition of JV to avoid being subject to taxation under Pillar One applied twice.

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Please contact me or one of the contacts listed below if you would like to discuss any aspect of our response in more detail or seek to ascertain views on other issues.

Yours sincerely,

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