Comments of the G-24[1] on the Progress Report on Amount A of Pillar One

Submitted for the Public Consultations on August 15, 2022

1. G-24 appreciates the G20/ OECD Inclusive Framework (IF) for its continued effort to develop a consensus solution for addressing the tax challenges arising from digitalisation and for releasing the Progress Report on Amount A of Pillar One for public consultation.

2. G-24 has always favoured rules that are fair, simple and capable of being implemented effectively by developing countries. At the same time, it is important that the adoption of the Two Pillar solution results in meaningful revenues, especially for developing counties, so that the solution is sustainable.

3. On a plain reading of the body of substantive rules proposed by the Secretariat, there remains no doubt that the provisions envisaged will still be highly complex to implement and administer. Given the significant inter-jurisdiction variation in administrative capacities of members of the Inclusive Framework, the G-24 recognizes the acute need for intensive capacity building to facilitate streamlined implementation and adoption of the Amount A rules, which require changes through an MLC and relevant domestic laws.

4. G-24 recognises that to create trust in the proposed new international tax architecture, it is imperative that developing countries, which make up a significant number of Inclusive Framework jurisdictions, are provided adequate representation in the new governance structures that are being proposed to implement the new rules.

Specific Comments on Progress Report on Amount A of Pillar One

National Tax Measures

5. We note that the Secretariat Report (Section 1: Overview, Paragraph 4) proposes to include within the Multilateral Convention, a commitment not to enact any future Digital Services Taxes or similar measures. We should be conscious that any commitment beyond a political commitment, will effectively constrain future law-making powers of sovereign jurisdictions. Setting such a high legal bar runs the risk of undermining the consensus solution that the current work aims to achieve and will raise constitutional concerns in various jurisdictions. **For these reasons, we strongly urge that any commitment from jurisdictions to not enact future measures should be in the nature of political commitments only.** Further, in respect of the definition of relevant similar measures, consideration should be given that it

[1]This note was prepared by the G-24 Working Group on Tax Policy and International Tax Cooperation and is being submitted on behalf of the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development (G-24). Among G-24 member countries, Argentina, Brazil, Colombia, Cote D'Ivoire, Democratic Republic of the Congo, Egypt, Gabon, Haiti, India, Kenya, Mexico, Morocco, Nigeria, Pakistan, Peru, South Africa, Sri Lanka, and Trinidad and Tobago* (www.g24.org) are also members of the BEPS Inclusive Framework.

should not cover domestic taxes that apply equally to residents and non-residents, or if they are subordinate to the tax treaties.

6. It is noted from the documents released at the time of the OECD/G20 Inclusive Framework Statement in July 2021[2] and in October 2021[3] that Pillar One was stated to rewrite the dated international tax rules for the 21st century, by offering market jurisdictions new taxing rights over MNEs, whether or not there is a physical presence of the business in the markets. It was estimated that under Pillar One, taxing rights on more than USD 125 billion of profit will be reallocated to market jurisdictions each year[4]. The FAQs[5] note that under Pillar One, which will see more than USD 125 billion of profit reallocated to market jurisdictions, developing countries will stand to gain more than developed countries as a share of corporate income tax (CIT). We have genuine apprehension that many of the rules that have been designed may substantially reduce the quantum of profit available for allocation and even in some situations limit or reduce the profits that developing countries are taxing under the existing rules.

Withholding Taxes

7. In this context, we find the reference to the consideration of withholding taxes in Amount A in paragraph 5 of Section 1 in Progress Report highly concerning. The concern is two-fold - firstly Amount A is supposed to be a new taxing right which will operate as an overlay over the existing international rules and withholding taxes are levied as per the existing bilateral treaties and have no connection with the reallocation of the 25% profit above the 10% PBT of MNEs with revenues above Euro 20 billion. Secondly, there is no mention of the consideration of withholding taxes in the Inclusive Framework statement in July 2021 or October 2021. The consideration of withholding taxes is clearly beyond the October agreement.

7.1. We do not find any merit in the claim that withholding taxes will result in double counting. Withholding taxes are levied in respect of a limited set of payments only and there cannot be any presumption that they are related to residual profit only. On the other hand, withholding taxes are mostly linked to operational activities leading to routine profits and, therefore, outside the scope of Amount A. G-24 is of the considered view that any consideration of withholding taxes in Amount A will lead to erosion of existing taxing rights and will make Pillar One unattractive and meaningless for the developing countries.

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[2] Highlights brochure on Addressing the tax challenges arising from the digitalisation of the economy (July 2021) https://www.oecd.org/tax/beps/brochure-addressing-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf

[3] Highlights brochure and FAQ on Addressing the tax challenges arising from the digitalisation of the economy (October 2021) https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf

[4] Page 16 of Highlights brochure and FAQ on Addressing the tax challenges arising from the digitalisation of the economy (October 2021)

[5] Page 19 of Highlights brochure and FAQ on Addressing the tax challenges arising from the digitalisation of the economy (October 2021)

7.2. **It also amounts to a change of goal posts after the game has started as withholding taxes were not considered while deciding the percentage of allocation of residual profits in October 2021 agreement.** The developing countries have already made many compromises including a low percentage share of residual profits and high revenue threshold for in-scope companies and therefore, any consideration of integration of withholding taxes within the Amount A is a cause for serious concern. **G-24, therefore, strongly urges the Inclusive Framework to keep withholding taxes out of Amount A allocation or elimination mechanisms.**

Marketing and Distribution Safe Harbour (MDSH)

8. It is noted that in paragraph 5 of Article 6 of the Progress Report on Amount A, the formula for the application of the Marketing and Distribution Profits Safe Harbour (MDSH) adjustment has been proposed. In this regard, it may be mentioned that as per the October 2020 Report on Pillar One Blueprint, MDSH was to be applied only in cases of marketing and distribution entities. However, as per the proposal in the Progress Report, the scope of MDSH is much broader than the name suggests and is no longer a safe harbour but is designed more like a capping mechanism to artificially limit routine profit allocated to countries under the existing transfer pricing mechanism. This is a cause of concern for the developing countries that were expecting increased revenues from Pillar One and in fact can act as a disincentive for them to join Pillar One

8.1. Further, the MDSH formula proposes to use quantitative criteria such as Return on Depreciation and Payroll (RoDP) to identify residual profits already taxed in a market country. RoDP is not the correct metric to determine residual profits as it fails in a number of cases, especially in cases of marketing and distribution entities which have low payroll costs and hardly any assets. **Considering the nature of MDSH and the available literature on the subject, G-24 suggests that a composite metric based on a return of 30% of global profit margin on sale (revenue as per revenue sourcing rules) and 40% RoDP on a jurisdictional basis may be considered to be an alternative metric.**

Rule on Elimination of Double Taxation (EDT)

9. In reference to Footnote 4 in the Progress Report on Article 9, we note that there is a logical inconsistency in the design of the elimination approach. Consistent with the October statement, the tiers for the elimination of double taxation have been designed so that tax liability will be drawn from jurisdictions earning residual profit and accordingly Tier 3A and 3B have been introduced. Tier 3A with the 40% Return on Depreciation and Payroll (RoDP) prevents dipping into routine profits for elimination except where the full elimination could not be accomplished after utilising all profits above the 40% RoDP threshold. However, in the present drafting of the rules there can be a situation when the group RoDP is 26% or below resulting in the floor of the second tier itself being 39% (150% of 26%). In such a situation, it is logical that the elimination, in the first instance, takes place from the jurisdiction with a RoDP of 40% or above. This logical inconsistency needs to be corrected.

De minimis for EDT and MDSH

10. Both for the elimination of double taxation and MDSH, we welcome the concept of a de minimis. It may however be noted that de minimis is being proposed as an absolute number without any indexation and that limits its utility even in the medium term - as developing countries which may benefit from de minimis now will have the advantage just for a few years as their economy will grow and they would soon be ineligible for such de minimis benefit. **We, therefore, suggest that for a de minimis to be effective, it should be based at least on profit in excess of the respective thresholds applied for EDT and MDSH. This will also be consistent with the policy rationale of Amount A which applies to residual profit and not to all profit.**

Averaging Mechanism and Loss carry forward

11. We note the contours of the averaging Mechanism proposed by the Secretariat and its application in the Scope of the building block. Any such mechanism should be designed such that it does not add unnecessary complexity and compliance burdens on MNE groups on the one hand and does not unnecessarily delay the entry of MNE groups into the Amount A architecture. The averaging mechanism has been designed only to keep MNEs out of scope. Any delay in entry would reduce residual profits thus adversely affecting the trade-off between stability and residual profit. Further, once a group comes into scope it should not be eligible for any averaging mechanism. Incorporation of unnecessary or artificial barriers to entry into the Amount A architecture will undermine the trust and stability of the solution itself and should be avoided. We note that the Secretariat has proposed a two-pronged test which is to be applied if a group has never been in the scope of Amount A or if after entering into the Amount A Architecture it drops out for two consecutive years. In light of adverse consequences for the developing countries by way of reduction in allocable residual profits due to the incorporation of averaging rules, the **G-24 urges that there should be no permanent test. However, if the same is not possible, with a view to arrive at a consensus, once the group is in scope after the application of the averaging mechanism, the current proposal be modified to increase the time period from two consecutive periods to at least five consecutive periods, after which averaging of profitability may apply. The prior period test for determining entry shall naturally not apply to such a 'permanent test'**

12. G-24 urges that proposed periods for carry forward of losses should be as short as possible because extended periods will reduce global residual profit available for reallocation. It is important to consider the sensitivities of developing countries to the proposed recognition and carry forward of pre-implementation losses when pre-implementation profits were never shared with market jurisdictions. The preference for the shortest possible time periods is underpinned by the need to keep the rules simple and administrable with the aim to lower the compliance burden for both MNE Groups and tax administrations. Further, a shorter period for loss carry forward will mitigate the need for extended loss tracking. **In light of this, our preference is for a pre-implementation loss recognition of 2 prior years and a carry forward period for both pre and post-implementation of 8 years.**

Predominance test for Excluded sectors

13. The G-24 notes the mechanism proposed in the Report to determine the contours of the exclusion for Extractives and Regulated Financial Services. The draft proposes to apply what in essence is a predominance test benchmarked on 75%, which implies that if an entity or segment derives 75 % or more of its income from activities categorized as Extractives or Regulated Financial Services, income from the entire entity/segment is excluded from the scope of Amount A. However, if the threshold is not met, then the exclusion is circumscribed to the part which is derived from Extractives or RFS. **We do not find any basis for this inconsistent treatment and question this lopsided rule which in essence is a pull-out mechanism and not a pull-in mechanism. Therefore, it is proposed that the predominance test percentage should be increased to at least 85%.**

Exclusion of Reinsurance and Asset Management from the scope of Amount A

14. We note the contours of the proposed Exclusion from Amount A for Regulated Financial Services. We recall the principle underpinning such exclusions as they are contained in the October 2020 Blueprint, the gist of which is that macroprudential regulation imposed on certain Financial Service sectors has the effect of aligning the location of the market with the location of taxable profits. The ensuing profits from these sectors then have sufficient merit to be excluded from Amount A reallocation because their activity generates taxable profits in the markets where they operate, so there is no need to reallocate profits under Amount A. **However, profits from reinsurance and asset management are often booked in jurisdictions other than where their markets are located. Their proposed exclusion abrogates the principle underpinning the Regulated Financial Exclusion itself and as such creates a blatant inconsistency in the application of the Rules. We, therefore, strongly urge that reinsurance and asset management should be in scope.**

Losses in respect of Covered Segment

15. The G-24 notes that Schedule D of Section 2 of the Progress Report contains provisions that are proposed to be applied to a Covered Segment. Section 5 of this Schedule, namely Paragraph 4(b) and Paragraph 7 apprise that work is ongoing to develop rules to codify treatment of transferred losses in the context of a Covered Segment. We foresee significant challenges pertaining to loss delineation and loss tracking in the context of segment loss transfers. Attempts to incorporate rules to accommodate these will surely increase complexity. In the interest of simplicity and administrability, we urge for non-recognition of transferred losses in the context of Segmentation.

Consideration of non-controlling interest

16. G-24 notes that Article 5 on Determination of the Adjusted Profit Before Tax of a Group consideration is proposed for adjustment of treatment of profit attributable to non-controlling interests. A space holder has been placed to determine the treatment of profit attributable to non-controlling interests, and to identify whether or how such profit should be included or excluded in the tax bases. As the Progress Report, itself states, Amount A is a new taxing right

which applies to a portion of the residual profit of large and highly profitable enterprises. Therefore, it is the companies who are and must be, covered, regardless of their shareholders and of the participation of those shareholders in those companies. The profit subject to this new taxing right is those obtained by the companies, which is different from the one made by the shareholder. Each shareholder, regardless of its participation, is making a contribution in order to allow the company to operate and obtain profits as a separate legal entity from its shareholders. Thus, we see no technical nor political reason to introduce a special treatment and in addition, including a special rule would add unnecessary complexity to Amount A's design.

Reflections on other Aspects of Amount A

17. The G-24 appreciates that the gamut of rules related to Amount A, dovetail into the mechanism that has been envisaged for tax certainty which will be utilised to ensure dispute prevention and resolution. Panels will be tasked to adjudicate disputes/disagreements related to the allocation of Amount A to market jurisdictions. The panels will be expected to perform what is in essence a sovereign audit function for Amount A and till date, there seem to be no tax administrations that outsource their audit function to independent parties. **The G-24 would like to place on record its concerns relating to confidentiality, impartiality and conflict of interest where independent experts are proposed to be included on such panels.** During the Public Consultation on the Tax Certainty Framework[6], Business has raised similar concerns because Panels are expected to be privy to very sensitive non-public material information of the largest and most profitable MNE Groups of the world.

18. Binding and mandatory dispute prevention and resolution structures of such scale and relevance are being attempted for the first time in the history of global taxation and it will be critical that participating jurisdictions and more specifically developing countries are provided adequate representation and voice within the new mechanisms to enable trust in the new frameworks. Such trust will be crucial for the long-term stability and sustainability of the Amount A Framework.

Reflections on Amount B

19. The G-24 recognizes that technical work on Amount B is currently in progress. We support work on Amount B since we believe that it will simplify the benchmarking of "baseline" marketing and distribution activities while adhering broadly to the ALP principle. It will also be particularly helpful for low-capacity jurisdictions where data on local comparables is not available. Overall, we believe that the Amount B project will provide tax certainty to taxpayers, help tax administrations in saving time and resources in benchmarking these baseline activities and will also be useful in resolving disputes where they already exist. We accordingly, strongly support the work and want it to be concluded before the end of 2022.

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[6] https://www.oecd.org/tax/beps/public-comments-received-on-tax-certainty-aspects-under-amount-a-of-pillar-one.htm