USCIB

UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

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<u>VIA EMAIL</u>
Tax Treaties, Transfer Pricing and Financial Transactions Division
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Re: USCIB comments on the OECD Public Consultation Document "Pillar One – Amount A: Draft Model Rules for Domestic Legislation on Scope"

Dear Sir or Madam,

The Tax Committee of USCIB submits these comments in response to the OECD Public Consultation Document "Pillar One – Amount A: Draft Model Rules for Domestic Legislation on Scope" (the "draft rules" or the "Document"). USCIB is a multi-industry sector US trade association that promotes open markets, competitiveness and innovation, sustainable development, and corporate responsibility. Its members comprise of leading U.S.-based global companies from every sector of the US economy and professional advisory firms, both groups of which typically have operations in every region of the world.

We recognize the work that the OECD Secretariat, the members of the Inclusive Framework on BEPS (the "IF"), the Task Force for the Digital Economy ("TFDE"), and the OECD technical working parties have invested in designing the rules for the implementation of Pillar One (collectively, the "drafters").

We are pleased to provide comments on this Document and the further Pillar One Consultation Documents to be published. The comments herein generally reflect the consensus position of USCIB, unless otherwise provided.

As a general comment we consider that the reduction in the revenue threshold from EUR 20 billion to EUR 10 billion, eight years from the effective date of Pillar One, is even more reason that the scope rules should not create significant additional complexity and compliance burden for in-scope MNEs.

Throughout this document USCIB has included recommendations that, in the view of our membership, could improve the application of the scope rules. These recommendations concern:

- The rules equivalent to prior period and average test should apply to the revenue threshold for all purposes.
- The prior period test and the average test should be a permanent feature of the revenue and profitability thresholds.
- Once in scope for the first current period, a Group should have the option to remain in scope for a fixed period.
- Comments on targeted exclusions for extractives and regulated financial services must be reserved until the OECD has published all draft rules on such targeted exclusions.

- A Domestic Exclusion should be added to the threshold calculations for simplicity and policy consistency.
- Symmetry of Pillar One and Pillar Two definitions, where possible.

Specific Comments

Article 1 Covered Scope

Revenue and Profitability Thresholds

USCIB would like to see the profitability threshold calculation take into account profit shortfalls (i.e., to the extent below 10%) for any prior period included in the corresponding test.

The Model Rules on Scope should specifically provide that revenue and profits that are within Amount B are excluded from Amount A.

Specific Questions from the Background Section of the Document

"Whether the total revenues of a Group should be subject to equivalent rules as the prior period and the average test."

USCIB supports the adaption of the prior period and average tests for measuring the Total Revenue threshold.

"Whether the prior period test and the average test should apply, as currently drafted, as a permanent feature of the scope rules or, alternatively, apply as an "entry test" only. Under the latter option, once a Group falls in scope of Amount A for the first time, the prior period test and average test would no longer apply, and thereafter only the Total Revenues and profitability of the Group in the current Period would determine whether the Group is in scope."

USCIB supports the use of the prior period test and the average tests (collectively, "the dual tests") as permanent features of the scope rules for both measuring the Total Revenue and the Profitability thresholds of scope.

Group Option to Remain in Scope of Amount A

Furthermore, a Group that is within scope of Amount A should have the option to be treated as in scope of Amount A for a fixed term (e.g., three periods) following any current period for which it is determined in scope of Amount A under the dual tests, without regard to a disqualifying result under either the Total Revenue test or the Profitability test that would otherwise treat the Group as out of scope for any period during such three period term. This option will be incorporated into the dispute prevention process and include rules for the conditions under which such option will remain valid during the fixed term and, also at the option of the Group, extended for additional fixed terms. This option will apply only for those Groups that wish to remain in scope of Amount A and would apply for all aspects of the dispute prevention processes. It would apply only at the group level and not at the market jurisdiction level which allocation would still be based on revenue sourcing actuals for any period. This feature will enhance tax certainty in a significant way for taxpayers and ease the compliance burden for both Groups and tax administrations that would otherwise share the risk that Groups would have to switch their compliance systems back and forth between an Amount A regime and the out of Amount A scope, arm's length principles for taxation. We also make this proposal in light of the significant expansion of Amount A anticipated within 8 years of the effective date of Pillar One due to the reduction of the Revenue Threshold from EUR 20 billion to EUR 10 billion.

Segment Thresholds – Same Test Principles

We generally agree with the approach described in the Background (page 3) to include a disclosed segment in Amount A under the same application for the revenue and profitability thresholds as above.

Targeted Exclusion Thresholds – Insufficient Guidance

USCIB is unable to make further comments on any references in this Document to the targeted exclusions for extractives and regulated financial services until the detailed model rules for such exclusions have been published for consultation.

Extractives

Footnote 7 of the Document seems to state the logical application of the revenue and profitability threshold tests in these draft rules to targeted exclusions. It should be clarified in the Model Rules, however, that once a relevant Group fails to meet either of the revenue or profitability tests after the removal of the excluded revenue and profits amount, then no further segmentation of the Group's revenues and profits is required.

Investment Funds Exclusion

The Model Rules should clarify that Investment Funds be excluded for purposes of the Covered Group tests.

New Domestic Exclusion with respect to Certain Goods and Services

The initial premise of Pillar One, for MNE's within scope, was to reallocate a portion of their returns above 10% on international profits to market jurisdictions in addition to an arm's-length return (Amount A). In the stated interest of simplicity, it was subsequently agreed that global financial statements would be the starting point in measuring the Amount A. Previous OECD discussion drafts appeared to consider the possibility for taxpayer initiated financial segmentation (product and/or regional segmentation). Although this topic remains reserved for future consideration, we understand segmentation will be reserved solely to allow governments to segment a taxpayer's financial statements to avoid perceived "under calculation" of Amount A. Material distortions which over-allocate to market jurisdictions from the use of global financial statements will not be available for segmentation by taxpayers. The indicated concern is that taxpayer initiated will be too complex, subjective and capable of manipulation. The proposed simplified domestic exclusion attempts to address these concerns while more accurately calculating a representative Amount A.

USCIB is therefore in favor of an elective exclusion from the Revenue and Profitability tests for the revenue from goods that are manufactured and sold and used within the same jurisdiction of a Group and, similarly, for services performed and sold and used within the same jurisdiction of a Group. Under this approach, domestic sales (and profits) would be excluded from Pillar One in the same manner as the extractive and regulated financial services industries (referred to here as the "Domestic Exclusion").

We believe this approach is necessary from both a policy and political perspective. These concerns are not unique to the US. Due to the nature of the US market, it is more acutely a US policy and political concern. From a policy perspective, where a MNE's profits are not globally homogeneous, and the enterprise does not function like a unitary/globally integrated business (cross-border supply chains) distortions will likely occur. There is a risk that Amount A is globally overstated, and the market jurisdictions will be over-compensated where a domestic jurisdiction has higher than the global average profitability or has large domestically autonomous business segments. It is also highly unlikely than an allocation/elimination rule can compensate for this over-allocation. See the Appendix for illustrative examples, the principles of which are explained here.

The current global financial approach assumes domestic and international transactions have relatively the same level of profitability and are so integrated that a unitary tax policy is justified. This assumption may have merit for some industries but is not universally true. It is not a representative assumption where profits relate to business activity which does not involve material cross-border transaction or significant variability in profitability by geography. This submission defines the absence of material cross-border transactions below. We would also propose to define significant variability in profitability to exist where the domestic profitability has an operating profit percentage which is greater or less than a 10% difference than in the global operating profit average. The tax authorities of the jurisdiction of the Ultimate Parent Entity may have the opportunity to review and verify the eligibility of the election.

In an attempt to simplify what constitutes domestic manufacturing, the proposal proposes utilizing established customs Certificate of Origin rules to determine if a good is manufactured within the market. The proposed approach seeks to limit the Domestic Exclusion (with simplifying assumptions) to "closed system" profits. For goods transactions, any good made, sold, and consumed in the same jurisdiction and for service transactions, any service rendered by a domestic entity and consumed within the same jurisdiction).

Given excess returns are driven by the exploitation of intellectual property ("IP"), cross-border licenses of IP would not be eligible for the proposed Domestic Exclusion. These markets would not be considered "closed systems" due to the cross-border license of IP from the IP owner. Similarly, cross-border IP payments to the IP owner would not be eligible for the Domestic Exclusion.

Goods transactions would be deemed to be manufactured in the jurisdiction if the good qualifies as domestically manufactured under applicable customs Certificate of Origin rules. The currently proposed Revenue Sourcing and Nexus rules would apply to determine if a good is sold and consumed in the market. Further, the market can only qualify for the Domestic Exclusion if the IP relating to the goods transaction is owned and exploited in that same market.

Services rendered by a domestic entity within that domestic market for an unrelated customer would qualify for the Domestic Exclusion if sold and consumed in the same domestic market (using the proposed Revenue Sourcing and Nexus rules). Similarly, the market can only qualify for the Domestic Exclusion if the IP relating to the service transaction is owned and exploited in that same market. For this purpose, a sublicense right or distribution right (either exclusive or nonexclusive) to distribute a good or service in that jurisdiction would be considered the exploitation of IP in that jurisdiction for sales from the distributor to the customer.

Revenue from domestic goods and services transactions (as defined above) would be aggregated to determine the total MNE domestic revenues. The excluding factor referred to as the "Domestic Exclusion Percentage" would then be determined by reference to the proportion of total domestic revenues as compared to total revenues in that market. Total jurisdictional operating profit multiplied by the Domestic Exclusion Percentage would produce domestic profit to be excluded from Pillar One. Any remaining International Revenue and International Profit would be subject to partial re-allocation to market jurisdictions under the applicable Pillar One rules. Domestic sales and profits as defined above would be excluded from Pillar One in the same manner as the extractive and regulated financial industries exclusions.

Title 9 Definitions

Generally, the drafters should ensure that Pillar One terms common to Pillar Two are defined the same when possible and, when not possible, any deviations are specifically identified, and the rationale explained in the final Model Rules and related Commentary.

Excluded Entity

USCIB proposes that the "or" 85% threshold test (i.e., ownership and activities) that is in Pillar Two be similarly included here. Most of the other definitions such as for Investment Fund are identical to those in Pillar Two. The same policy rationale should apply across the two Pillars. This could cause some MNEs to come within scope of Pillar One because of the inclusion of Investment Funds (which may not, themselves, be included in the Regulated Financial Services exception) where just the 95% threshold test cannot be met, thereby inflating both the MNE revenue and profitability thresholds. The concern is compounded for these thresholds if there is a "carry" in which an asset manager's employees share in the Entity's profits.

The inclusion of the first 95% threshold and not the second threshold from Pillar Two is not an unnecessary expansion of Pillar One's exclusions. Instead, it acknowledges that there may be commercial reasons, such as "carry", for which Amount A should not be applied.

Consolidated Financial Statements

USCIB recommends that a framework be created in the Model Rules or MLC to arbitrate disputes and questions related to consolidated financial statements of a Group that may be considered unreliable because the underlying financial audits are not subject to meaningful regulatory oversight.

Pre-Tax Profit Margin

USCIB recommends that a framework be created in the Model Rules or MLC to arbitrate disputes and questions of competition from state-owned and state-sponsored enterprises and discovery of their profit margin in the marketplace.

Revenues

USCIB recommends that a framework be created in the Model Rules or MLC to arbitrate disputes and questions of competition from state-owned and state-sponsored enterprises and discovery of their revenues in the marketplace.

Specific dispute prevention and resolution considerations related to the Multi-lateral Convention (MLC) design

USCIB recommends that the drafters provide details about dispute resolution procedures for Amount A scope certainty. Although the draft rules propose a simplified approach that is quantitative, objective and administrable, disputes will likely still arise regarding whether a Group is an Amount A taxpayer. These disputes could be between a Group's Ultimate Parent Entity (UPE) and the tax administration of the jurisdiction in which it is a resident, among tax administrations of multiple jurisdictions, or both. Effective mechanisms will be needed for resolving such disputes.

It is unclear how processes for resolving scope disputes will be structured. For example, scope disputes between a UPE and its tax administration might be resolved through a simplified or jurisdiction-specific process, while scope disputes among jurisdictions' tax administrations would require a standardized process in the MLC. Scope disputes could be resolved separately from other Amount A disputes, or all disputes related to Amount A could be resolved through the same dispute resolution procedures.

Whatever structure is adopted for resolving scope disputes, confidentiality rules must protect any information submitted by a Group or its members. Ensuring confidentiality also suggests limiting the number of jurisdictions that have standing to challenge scope (e.g., to those with the most material actual or virtual taxpayer presence).

In addition, the features for resolving a scope dispute should be clear. For example, how often may a scope determination be challenged or reviewed? What events would support a scope re-determination? On which jurisdictions would the resolution of a scope dispute be binding, and for how long? These are some of many considerations to be covered in the dispute prevention and resolution processes.

We are available to the TFDE to discuss any aspects of our comments in this letter.

Best regards,

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Chair, Taxation Committee
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Appendix – Domestic Exclusion

Assume a U.S. MNE with the following facts: $100MM worldwide revenue and 20% worldwide operating profit. U.S. domestic revenues are $50MM with a 30% operating profit. Of the total U.S. revenue, 90% is derived from sales of products that are produced and consumed in the U.S. The remaining 10% of U.S. revenue is from cross border transactions – goods, services, and/or IP. Rest of World revenues are $50MM with a 10% operating profit. The U.S. owns all IP of the MNE group.

Pillar 1 – Illustrative Without a Domestic Exclusion

				= A * 10%	= C - D	Calculation Below	Pro-Rata Global Revenue	= F + G
	A	B	C	D	E	F	G	
	Total Revenue	Total Profit Margin %	Total Profit	Assumed Routine Rtn.	Excess Profit	Amount A (Surrender)	Amount A Receipt	Net Amount A (Sur) / Rec
U.S.	50,000,000	30%	15,000,000	5,000,000	10,000,000	(2,500,000)	1,250,000	(1,250,000)
Rest of World	50,000,000	10%	5,000,000	5,000,000	-	0	1,250,000	1,250,000
Total	100,000,000	20%	20,000,000	10,000,000	10,000,000	(2,500,000)	2,500,000	-

Global Amount A Calculation

Total Global Revenue	100,000,000	U
Total Global Profit	20,000,000	W = per above
10% Baseline Margin	10,000,000	X = U * 10%
Margin Over Excess	10,000,000	Y = W - X
Global Amount A	**2,500,000**	Z = Y * 25%

Please note: *Surrender rules are currently unknown. The above gross and net surrender is one possible approach. As a simplifying assumption, we have assumed the U.S. is the sole surrendering jurisdiction in this example. If the surrender allocation key is not directly linked to excess return jurisdictions (e.g., return on expenses or assets), it is possible the additional $1.25 million of Amount A ($2.5 million global Amount A less $1.25 million U.S. share) will need to be surrendered from markets other than the U.S, even though they did not earn an excess return.*

Alternatively, there are rumors the actual surrender approach may involve a pro-rata sharing from Amount A jurisdictions, or a "waterfall" approach or a hybrid of the two methods. Allocation methods other than a direct proportionate share of Amount A will produce distortions (over or under allocation of the surrender amount) by market.

OBSERVATION – $1,250,000 net U.S. surrender involves 90% of U.S. sales that are purely domestic. 2

<u>Assume a U.S. MNE with the following facts</u>: $100MM worldwide revenue and 20% worldwide operating profit. U.S. domestic revenues are $50MM with a 30% operating profit. Of the total U.S. revenue, 90% is derived from sales of products that are produced and consumed in the U.S. The remaining 10% of U.S. revenue is from cross border transactions – goods, services, and/or IP. Rest of World revenues are $50MM with a 10% operating profit. The U.S. owns all IP of the MNE group.

<u>Pillar 1 – Illustrative With a Domestic Exclusion</u>

			= C * B		= C * D	= C * 10%	= E - F	Calculation Below	Pro-Rata x-Border Rev	= H + I
	A	B	C	D	E	F	G	H	I	
	Total Revenue	**Domestic Exclusion %**	**International Revenue**	**International Profit Margin %**	**International Profit**	**Assumed Routine Rtn.**	**Excess Profit**	**Amount A (Surrender)**	**Amount A Receipt**	**Net Amount A (Sur) / Rec**
U.S.	50,000,000	90%	5,000,000	30%	1,500,000	500,000	1,000,000	(250,000)	25,000	(225,000)
Rest of World	50,000,000	-	50,000,000	10%	5,000,000	5,000,000	-	0	225,000	225,000
Total	100,000,000		55,000,000	12%	6,500,000	5,500,000	1,000,000	(250,000)	250,000	-

Note: 12% international profit margin is result of exclusion of U.S. domestic sales with 30% profit margin.

Global Amount A Calculation

Total International Revenue	55,000,000	*U*
Total International Profit	6,500,000	*W = Above*
10% Baseline Margin	5,500,000	*X = U * 10%*
Margin Over Excess	1,000,000	*Y = W - X*
Global Amount A	**250,000**	*Z = Y * 25%*

<u>Please Note:</u> Similar to previous example, the above example assumes a simplified allocation where the U.S. is the sole surrendering jurisdiction, because it is the only jurisdiction with Amount A excess profits.

If the surrender rule uses any alternative allocation method, as noted previously, distortions will occur and some jurisdictions without excess returns (Amount A) will be expected to surrender tax base.

OBSERVATION – $225,000 of excess profits on U.S. cross border sales surrendered to rest of world market jurisdictions.

<u>Application of a domestic exclusion prevents the re-allocation of $1,025,000 of purely US domestic tax base to market jurisdictions.</u>

Assume a US MNE with the following facts: Under the proposed Pillar 2 design, the US is determined to have a 10% effective rate due to deferred tax accounting and non-qualified domestic tax credits. As a result, the U.S. is determined to have a top-up tax amount of 5%, subject to re-allocation under the UTPR rules.

Pillar 2 – With and Without a Domestic Exclusion

UTPR: No domestic exception

$750,000 UTPR re-allocation from U.S.

Total U.S. Sales	**$ 50,000,000**	
U.S. Profit Margin	**30%**	
U.S. Net Profit	**15,000,000**	
UTPR Rate Difference	**5%**	***= 15% Pillar 2 Min Tax - 10% Effective Rate***
Pillar 2 UTPR Amount	**$ 750,000**	

UTPR: Domestic exception

$ 75,000 net surrender from 10% cross-border revenue

Total U.S. Sales	**$ 50,000,000**	
Domestic Exclusion Percentage	**90%**	
Net U.S. Cross Border Sales	**5,000,000**	***= Total U.S. Sales * (100% - 90%)***
U.S. Profit Margin	**30%**	
U.S. Net Profit on Cross Border Sales	**1,500,000**	
UTPR Rate Difference	**5%**	***= 15% Pillar 2 Min Tax - 10% Effective Rate***
Pillar 2 UTPR Amount	**$ 75,000**	

Without a domestic exclusion, $675,000 of purely US domestic tax base is re-allocated to market jurisdictions.