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US International Tax Alert

OECD Pillar One – Amount A Multilateral Convention

On October 11, 2023, the OECD published the "current consensus" of a multilateral convention for the implementation of Pillar One Amount A ("Pillar One MLC" or MLC). The Pillar One MLC was accompanied by an explanatory statement and an Understanding on the Application of Certainty under Amount A. The OECD also published an updated estimate of the economic impact of Amount A and an overview document. Taken together, these documents represent about 1,000 pages of text.

Importantly, the Pillar One MLC is not yet open for signature as there are still areas being negotiated, largely defined in the footnotes to the Pillar One MLC. On October 16, US Treasury Secretary Yellen told reporters that the negotiations with respect to the Pillar One MLC "will take into next year."

In a previous July 2023 Outcome Statement, the OECD had expressed the view that "[t]he MLC will be opened in the second half of 2023 and a signing ceremony will be organized by year end, with the objective of enabling the MLC to enter into force in 2025, allowing for the domestic consultation, legislative, and administrative processes applicable in each jurisdiction." The July Outcome Statement also explained that, subject to at least 30 jurisdictions accounting for at least 60% of the Ultimate Parent Entities (UPEs) of in-scope multinational entities (MNEs) signing the MLC before the end of 2023, members of the Inclusive Framework agreed to refrain from imposing newly enacted digital services taxes (DSTs) or relevant similar measures, as defined in the MLC, on any company between January 1, 2024 and the earlier of December 31, 2024, or the entry into force of the MLC. This represents a one-year extension of the current moratorium on such taxes, which was originally agreed to run through the end of 2023 unless the MLC came into force sooner. *Given the ongoing negotiations and the fact that the MLC will not meet the target metrics for signatories before year-end, it remains an open question whether countries will agree to a continuation of the DST standstill.*

The US Treasury announced a request for public input by December 11, 2023, on the Pillar One MLC and accompanying documents, explaining:

> "The Treasury Department considers the release of the draft Pillar One documents a key step forward in the Pillar One negotiations. These documents reflect countless hours of discussions, across multiple US administrations, and among hundreds of negotiators. Treasury stands behind the negotiations, which have resulted in many difficult

> compromises by all sides with respect to both the design of the partial reallocation of taxing rights and the elimination of discriminatory digital services taxes and similar measures," said Assistant Secretary for Tax Policy Lily Batchelder. "However, as the cover note in the documents states, Pillar One represents a uniquely significant reform to the international tax system. Because of the breadth and complexity of the changes proposed, we view public input as critical to our process – to ensure transparency, to facilitate the resolution of several remaining open issues, and to hear whether the proposed framework would be workable for US taxpayers and other stakeholders."

The Pillar One MLC follows along the lines of the Amount A discussions to date without notable departures, although there is surely more detail in these documents than was previously available in public. Among the items worthy of note:

- Issues around withholding tax at source on royalties, technical fees/services, and interest that already allocates tax to market countries have been largely addressed with adjustments to minimize double taxation. Some open points remain under discussion, however, particularly on the adjustments for withholding taxes, and the text of the multilateral convention notes objections by India, Brazil, and Colombia in this regard.
- Amount A now includes a targeted exclusion for defense entities, which uses broadly the same approach as the exclusions for extractives and regulated financial services, as well as an exemption for "purely domestic-oriented" businesses.
- For businesses within the scope of DSTs, there is a useful annex identifying the specific DST measures (including the UK DST and other European DSTs, plus the equalization levies in India) that will be withdrawn as part of the Amount A implementation. Signatories of the MLC will also commit not to introduce a DST or relevant similar measure in the future; a country that does so will not receive an allocation of Amount A tax.

The relevant provisions of the Pillar One MLC are described in more detail below.

Amount A rules

The Amount A rules reallocate taxing rights to market countries through the creation of a new taxing right over "Amount A" profits. The complex rules set out in the Pillar One MLC comprise five steps:

Step 1. Determine if the business is in scope

- **Group revenue and profitability test:** The Amount A rules broadly apply to groups that have revenue in the period of greater than €20 billion (revenue test) and an adjusted pre-tax profit margin of greater than 10% (profitability test).
- **Segmentation rule:** Exceptionally, where a group does not meet the thresholds but one of the segments disclosed in its consolidated financial statements meets the group revenue and profitability tests on a standalone basis, the segment is in scope.

- **Limited exclusions apply to specific industries:** extractives; financial services and (new) defense.
- **"Autonomous Domestic Business Exemption":** Where this applies, a country will neither be obliged to relieve double taxation nor allocated Amount A with respect to that business. The exemption applies where a business meets quantitative tests designed to assess the level of the integration of a potentially "purely domestic-oriented business" in a jurisdiction with the rest of the group. The quantitative tests examine the level of revenues sourced to the country, cross-border intra-group revenues, and cross-border intra-group expenses.

Step 2. Identify eligible market jurisdictions

- **Revenue sourcing rules:** Revenues must be sourced to individual market countries according to the category of revenues earned. Revenues that fall under more than one category are sourced according to their predominant character.
    - Businesses may source revenues from supplementary transactions in line with the rules applicable to the main transaction.
    - Each category of revenues has its own specific sourcing rules, including the sourcing principle, potential reliable indicators (i.e., sources of information), and any allocation keys.
    - The specified categories of revenues are finished goods; digital content; components; services (location-specific services, advertising services, online intermediation services, passenger transport services, cargo transport services, customer reward programs and other services); intangible property (relating to finished goods, components, services, and digital content); user data; immovable property; government/international organization grants; and non-customer revenues.
    - During an initial transition phase, groups are not required to apply the specific sourcing rules and instead may apply the relevant broad allocation keys. This covers the first three periods for Amount A.
- **Nexus test based on revenue:** A market country will be entitled to an allocation of Amount A only if it has *sufficient* "nexus," i.e., if the group's annual revenues arising in the country exceed €1 million. A lower threshold of €250,000 applies for countries with a GDP of less than €40 billion.

Step 3. Calculate and allocate a portion of excess profit

- **Determine relevant group profit:** The Amount A tax base is determined using the financial accounting profit/loss of the consolidated financial statements. A relatively limited number of book-to-tax adjustments are required to determine adjusted profit before tax.
- **Allocate a portion of excess profit to markets:** The total amount of profit that can be reallocated under Amount A is 25% of a business's profit above a 10% profit margin. Profits are reallocated to market countries in proportion to sourced revenues.

Marketing and distribution profits safe harbor

The marketing and distribution profits safe harbor aims to address "double counting" issues where a market country already taxes some portion of the residual profit. After an initial "grace" period, withholding taxes (including taxes withheld on interest, royalties, and technical fees) are taken into account in the calculation and can reduce the profits allocated to a market jurisdiction under Amount A. Withholding taxes on dividends and capital gains are not taken into account. The marketing and distribution profits safe harbor applies when the adjusted profit before tax in a jurisdiction is €50 million or more.

Step 4. Eliminate double taxation

- **Determine relevant jurisdictional profit and return on depreciation and payroll:** "Return on depreciation and payroll" is used as a proxy for profitability and to identify which countries are required to eliminate double taxation.
- **Allocate obligation to relieve double taxation to jurisdictions:** The obligation to eliminate double taxation arising with respect to any Amount A liability will be allocated among countries that earn residual profits ("relieving jurisdictions") using a formulaic tiered approach. Obligations are first allocated to jurisdictions with the highest "return on depreciation and payroll." Withholding taxes suffered at source on income received reduce the residual profits and therefore potentially the obligation of a jurisdiction to relieve double taxation.
- Identify relief entities within a jurisdiction using a formulaic approach based on profit.

Step 5. File and pay

- A *central coordinating entity* will file the Amount A tax return and common documentation package with the lead tax administration, typically the parent jurisdiction. The deadline for filing will be between nine and 12 months from the end of the period, as determined by the filing country. Tax authorities will exchange information with affected countries. A standard Amount A tax return and common documentation package template will be developed.
- Payment of tax by a *single group entity* ("designated payment entity") is due 18 months after the end of the period. "Relief entities" are required to make compensating payments to the designated payment entity, which are disregarded for all tax purposes.
- Double taxation relief should be provided by the relieving jurisdiction within 90 days of the submission of a claim (or through a reduction in installment payments).

Tax certainty

A tax certainty framework for Amount A includes mechanisms designed to provide *binding* certainty: an Advance Certainty Review of the methodology used by a business, e.g., for revenue sourcing; a Scope Certainty Review for potentially out-of-scope businesses; and a Comprehensive Certainty Review of a business's application of the Amount A rules in all relevant countries.

Enhanced tax certainty processes have been developed with respect to disputes over existing tax treaty rules that potentially affect Amount A calculations. A mandatory binding dispute resolution process is available for related issues that are unresolved in a Mutual Agreement Procedure (MAP). A related issue is a transfer pricing, business profits/permanent establishment, or withholding tax characterization dispute covered by a tax treaty.

Developing countries that are not members of the OECD or G20 and that have had low levels of MAP disputes are generally entitled to an elective (rather than mandatory) dispute resolution process.

Removal of digital services taxes

The MLC includes a list of specific measures that must be removed for all businesses (including those not in the scope of Amount A) as part of the implementation of Amount A. The list includes the DSTs implemented by Austria, France, Italy, Spain, Tunisia, Turkey, and the UK, as well as India's equalization levies on online advertisement services and e-commerce.

Countries that impose a DST or other relevant similar measure will not receive Amount A tax allocations of taxable profit, even where they are market countries and would otherwise be entitled to them.

A digital services tax or other relevant similar measure is one that meets the following conditions:

- Its application is determined primarily by reference to the location of customers or users;
- It is either:
    - Applicable solely to non-residents or foreign-owned businesses; or
    - Applicable in practice "exclusively or almost exclusively" to non-residents or foreign-owned businesses as a result of thresholds, exemptions for businesses subject to domestic corporate tax, or other restrictions (with the effect that domestic businesses are insulated from the tax); and
- The tax is not treated as an income tax.

In addition, "significant economic presence" concepts that are in the scope of tax treaties do not meet the criteria to be treated as DSTs, but countries that ratify the MLC will not be able to apply such taxes to in-scope businesses once the Amount A rules apply.

Next steps

The multilateral convention reflects the current consensus among Inclusive Framework members. Negotiating jurisdictions are continuing to work towards agreement on specific outstanding areas (as noted in footnotes to the MLC). Once the MLC has been finalized, it will be opened for signature. The MLC will enter into force once it has been ratified by at least 30 countries accounting for at least 60% of the ultimate parent entities of businesses expected to be in-scope for Amount A. The representation of ultimate parent entities is determined on a points system reflecting the estimation of the number of very large in-scope multinationals per country. The US, with the largest number of in-scope multinationals, must ratify the multilateral convention for the Amount A rules to take effect. It is important to note that in the US signing of the MLC by the executive branch is not ratification, which requires the advice and consent of the US Senate and the signature of the President.

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