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

4 March 2022

Tax Treaties, Transfer Pricing, and Financial Transactions Division (OECD/CTPA):

Thank you for the opportunity to provide feedback on the Public Consultation Document (PCD) for Pillar One – Amount A: Draft Model Rules for Tax Base Determinations.

The Information Technology Industry Council (ITI) is the premier global advocate for technology, representing the world’s most innovative companies. Founded in 1916, ITI is an international trade association with a team of professionals on four continents. We promote public policies and industry standards that advance competition and innovation worldwide. Our diverse membership and expert staff provide policymakers the broadest perspective and thought leadership from technology, hardware, software, services, and related industries.

Our members have consistently supported the negotiations at the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework (OECD/IF), including through regular technical engagement and the May 2020 publication of Principles for a Solution in the OECD’s Project for Addressing the Tax Challenges of the Digitalisation of the Economy. Global tax policy challenges require global tax policy solutions, which is why more than 140 governments and more than a dozen observer organisations have committed to the negotiations taking place under the auspices of the IF. We appreciate the opportunity to provide feedback on the draft Model Rules and intend to continue engagement with the OECD and the IF as development of model rules, legal instruments, and other elements of the Two-Pillar Solution continues.

ITI’s suggestions primarily focus on tax base calculations, treatment of losses, and issues related to business combinations. As an overarching comment, we want to emphasize that the Pillar One tax base should generally align with the Pillar Two GloBE tax base. This would improve both administrability and certainty as taxpayers and tax administrations are looking towards implementation.

General Articles and Definitions

The draft Model Rules include several references to guidance that will be developed further in the Commentary (e.g., Eligible Restatements, Business Continuity Conditions, etc.). While we have provided feedback based on the draft Model Rules, we recognize the administrability of the Model Rules will rely in large part on decisions actively under consideration by the Task Force on the Digital Economy (TFDE) and details, examples, and guidance to be articulated in the Commentary. We strongly encourage the OECD to provide an opportunity to comment on the more detailed rules once they are available, particularly to ensure ease of administration and compliance.

The Background states that jurisdictions “could use [the Model Rules] as the basis” and “will be free to adapt these Model Rules.” Clarification is needed where the rules state jurisdictions will be free to adapt these Model Rules. Although the rules also recognize the need for consistency, it needs to be
clear that the rules for tax base determinations cannot diverge in different countries in ways that would result in double taxation. The potential for discrepancies underscores the strong need for an early certainty process and mandatory binding dispute prevention and resolution mechanisms for all participating jurisdictions to ensure there will be effective resolution of definitional questions and determinations about reliability of data sources.

**Tax base calculations**
Consideration should be given to, and optional adjustments be allowed in, cases where there are differences between International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (GAAP) which may disadvantage U.S. multinational enterprises (MNEs).

Gains and losses associated with disposal of equity interests, including disposition of a controlling interest, should be excluded from the tax base, as should equity gains and losses. Covered Groups that invest in other entities will have both realized and unrealized gains and losses for these investments under both the cost method of accounting and the equity method of accounting. As noted in Footnote 3, these gains and losses are not part of the underlying business of the Covered Group but rather are “generated by another entity” and therefore should be excluded from the Amount A tax base. Additionally, these gains and losses may be reported in Other Comprehensive Income or in Other Income (on the face of the income statement), so there should be no differentiation between where the gains and losses are recorded. If the unrealized gains and losses from the mark-to-market of equity interests being held as of the balance sheet date, or the realized gains and losses from the sale of equity interests during the period is included in the tax base in any way, a separate sourcing rule would be required to allocate that to the jurisdiction(s) making the investment decisions, as the market jurisdictions should not receive any allocation of profits if there is no connection. Profit or loss derived from a joint venture (JV) should also be excluded based on the potential for double counting at the JV level.

The definition for Tax Expense should clarify that Tax Expense (or Tax Income) does not include interest charges for payments on tax assessment consistent with interest charges for late payment of charge.

Footnote 11 requests input on an applicable cap on the Eligible Restatement Adjustment for the Period and states the level of the cap will be subject to further analysis to balance competing objectives of simplicity and avoidance of excessive single year impacts. The application of a cap on restatement adjustment adds additional complexity and may not be consistent with a goal of minimizing complexity and burden to taxpayers. A restatement adjustment carryforward would not be reflective of better matching to the related closed period or consistent with the approach taken in relation to other elements of the Amount A calculation (as noted in the introduction).

**Treatment of losses**
We appreciate the draft Model Rules’ incorporation of an earn-out mechanism, which ITI previously recommended in our December 2020 response to the Reports on the Pillar One and Pillar Two Blueprints.1 Relatedly, there should be unlimited ability to carryforward losses in order to reflect accurate profitability over time and ensure taxable base does not exceed true economic income. A

---

recent paper on the treatment of losses found that “more than 96 percent of companies operating in the healthcare sector and nearly 80 percent of those in the information technology sector take longer than 10 years to break even.” As such, for many businesses, permitting anything less than 10 years of carryforward (and as little as two years) is not sufficient. Many IF jurisdictions currently allow unlimited carryforward of losses under domestic tax law. The rules should permit unlimited or at the very least a 15-year carryforward period. This, combined with the earn-out approach, is necessary in order for the “relieving” jurisdictions to fully and appropriately recover the past investments and deductions they have granted relating to those losses.

There should also be parity between loss carryforward and losses available from years prior to the commencement date: pre-implementation losses should be carried forward for as long as post-implementation losses. There should be no distinction between these types of losses, particularly as the rules expressly provide that it is irrelevant (for both pre- and post-implementation losses) whether the Covered Group was a Covered Group in the prior Period (see paragraph (a) introduction).

The proposed loss carryforward regime currently follows a first-in-first-out approach. We agree that first-in-first-out would be a logical and administrable approach.

Relatedly, the PCD does not expressly address the concept of profit shortfalls, which was included in the October 2020 Pillar One Blueprint. The concept is to permit loss carryforwards for profit levels to the extent below the Amount A profitability threshold. This concept is logical and should be included in the Multilateral Convention and Model Rules. Regular domestic tax regimes tax profits above a 0% profit margin, so that 0% margin is the dividing line below which domestic losses and loss carryforwards are defined. Because Amount A taxes profits above a higher profit margin (10%), the higher profit margin should be the dividing line below which Amount A losses and loss carryforwards are defined.

**Issues related to business combinations**

The continuity of business requirement imposes considerable burden on the taxpayer to track and evaluate same or similar business across the designated period (including 12 months preceding the business combination). Continuity of business should be viewed as implicit in an Eligible Business Combination entered into by an MNE.

Footnote 13 seeks input on the applicable criteria in assessing whether one business is “the same or similar” to another. In many acquisitions, the acquired entity/assets are converted from being a principal in its own right, to undertaking similar business activities but compensated within the acquirer’s group on a limited risk basis (e.g., cost-plus). The test should look to the underlying activities (e.g., research and development) rather than the specific way those activities are remunerated.

In reference to the operation of “Transferred Losses” rules, as well as on the categories of business reorganisations that should be taken into consideration under this rule, Footnote 14 notes that the definition of an eligible business combination “applies without regard to the specific legal form of an

---

operation.” Eligible Business Combinations should include the purchase of stock or purchase of assets and liabilities of the transferred group as the case may be.

The categories of operations that should fall in the definition of an Eligible Business Combination, other categories of business combinations, as well as whether a portion of losses should transfer on a transfer of a portion of the Group. A portion of losses should transfer along with a portion of a transferred Group. These losses would have been generated partially from the underlying assets of the Transferred Entity(ies).

In Footnote 14: “For example, sub-paragraph (b) would cover the acquisition of 95% of an existing Group where the remaining 5% is liquidated; but it would not capture cases where, for example, one Group (Seller) sells part of its business to the Covered Group, where both the Seller and the Covered Group continue to exist as separate Groups following the operation. In the latter case, the losses (if any) that may have been incurred by the Seller prior to the transfer continue to be carried forward by the Seller following the transfer (i.e., the unrelieved losses continue to be carried forward at the level of the Group in which they were generated (the Seller).” A portion of the generated unrelieved losses would likely have been generated by the transferred portion of the group.

Footnotes 20 and 21 refer to the audited financial statements of a Transferred Entity. Acquired companies are traditionally much smaller than the acquiring Covered Group and likely will not have audited financial statements. We recommend providing an exception to the audited financial statement requirement if a Transferred Entity would not, on its own, have met the scope requirements for being subject to Amount A.

We appreciate that the OECD has treated stock and asset deals similarly for purposes of Transferred Losses to ensure the form of the deal does not change the outcome under Amount A. We look forward to further guidance on how an asset deal would qualify, but note that, in the example provided, it suggests that the target company would cease to exist. Since a formal liquidation may very well occur in a different period than the acquisition (liquidations often can involve time-consuming steps), a plan to liquidate or some certification of plans to liquidate or otherwise discontinue operations should be sufficient.

Stock-based compensation
The Pillar Two GloBE tax base allows an election to substitute the amount allowed as a deduction in the computation of its taxable income in its location for the amount expensed in its financial accounts for a cost or expense for stock-based compensation. The same election should be available for Pillar One in Title 5, Article 5(2).

Policy Disallowed Expenses
Policy Disallowed Expenses should be fixed as defined. Providing the ability for individual jurisdictions to adapt for domestic considerations and practices will result in a process which is inconsistent and not administrable.

Often the event that causes a Policy Disallowed Expense will be disputed (e.g., in litigation or regulatory proceedings). Particularly, if these accounting expenses are excluded in a prior year, any reversal in a later year if the challenge is successful must also be excluded.
The treatment of amortization of acquired goodwill is very different between Financial Accounting Profit (or Loss) and the tax regulations for goodwill in the IF countries. Goodwill amortization should be added to the list in Article 5(2)(a)(iv) as an adjustment between Financial Accounting Profit (or Loss) and the Adjusted Profit Before Tax. For accounting purposes, goodwill is tested annually for impairment and, if impaired, a loss is recorded in an entity’s financial statement. For most jurisdictions’ tax regulations, this loss is a non-deductible expense to the extent that the goodwill that was impaired was from a stock acquisition in which the entity has no tax basis in that goodwill asset, and the impairment expense should be added back for the determination of the Amount A tax base. Similarly, acquired goodwill with tax basis (for instance when the acquisition was an asset acquisition) is generally amortized for tax – but not accounting – purposes. This amortization should be allowable as a deduction for the determination of the Amount A tax base.

Scoping

The inclusion of loss carryforwards responds to the same conditions that merit providing MNEs the option of “smoothing out” the scoping criteria to determine whether a MNE is subject to the reallocation of profits under Amount A. Such an approach would provide greater certainty and alleviate administrative burdens by minimizing the effect of year-to-year fluctuations for taxpayers that do not have certainty year over year regarding the applicability of Amount A: analysis by Dr. Lorraine Eden found that of the top 200 MNEs on the Fortune Global 500 in 2018, “nearly 50% of the MNEs (98 firms) were not in the top 200 two years later.”3 The criteria employed to build the Fortune Global 500, of course, does not directly relate to the companies in scope of Amount A, but this underscores a need to account for variability, both in terms of profit margins and global revenues.

If multiyear averaging is adopted, it should be on an elective basis because otherwise this process may add complexity and compliance burden for taxpayers where there is in fact certainty year over year regarding the applicability of Amount A. Additionally, multiyear averaging would add complexity and questions for those companies as to the proper period in which to record the taxes for financial reporting purposes.

To provide greater certainty and predictability, ITI recommends allowing on an elective basis for MNEs to adopt an average over at least three years to determine whether an MNE is subject to the reallocation of profits under Amount A. The option for MNEs to elect for multiyear averaging should also extend to the concept of revenue shortfalls.

Conclusion

Thank you again for the opportunity to provide feedback on the Pillar One – Amount A: Draft Model Rules for Tax Base Determinations. As stated in the introduction, our members are committed to the success of the work taking place under the auspices of the Inclusive Framework, and see a multilateral, consensus-based solution as the only sustainable outcome. We appreciate the Secretariat’s attention to our concerns and stand ready to answer any questions that may arise.

---