

Pillar One draft Model Rules on scope of Amount A and exclusions for Extractives and Regulated Financial Services

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In brief

The Organisation for Economic Co-operation and Development (OECD) recently released the following Amount A draft Model Rules¹ under Pillar One of Base Erosion and Profit Shifting (BEPS) 2.0 for public consultation:

- (1) Domestic legislation on scope;
- (2) Extractives Exclusion; and
- (3) Regulated Financial Services Exclusion.

These rules determine when a Group will be in scope of Amount A, subject to exclusions for Extractive Activities and Regulated Financial Institutions (RFIs). They were released as part of a series of public consultations² on the Pillar One Amount A draft Model Rules that the OECD is expected to conduct over the coming months. This News Flash provides a short overview of these rules. For a more detailed discussion, please refer to the *PwC Global Tax Policy Alerts*³.

It is particularly important to note that the Inclusive Framework has not agreed to these draft rules. Rather, for the moment, they represent the work of the OECD Secretariat and therefore may be subject to change, unrelated to the consultation process.

In detail

Domestic legislation on scope of Amount A

A Group will be in scope of Amount A if it meets two threshold tests, namely the global revenue test and profitability test. The concept of 'Group' is broadly defined by reference to an Ultimate Parent Entity (UPE) that is set at a level where Consolidated Financial Statements are commonly prepared.

Revenues and profits from Extractive Activities and RFIs are excluded from the scope of Amount A. Generally speaking, a Group covered by the exclusions should reapply the global revenue test and profitability test after removing the revenues and profits from the excluded activities. A Group will be out of scope of Amount A if it is below either threshold after reapplying those tests.

The scope rules include an anti-abuse provision to prevent a UPE of a Group that is owned by an Excluded Entity⁴, Investment Fund or Real Estate Investment Vehicle from restructuring for the purpose of circumventing the scope rules (i.e. the anti-fragmentation rule).

The scope rules also include a placeholder for 'exceptional scoping provisions' which may apply to a disclosed segment as reported in a Group's Consolidated Financial Statements. These rules will operate in limited circumstances to bring a disclosed segment in scope of Amount A where it meets the revenue and profitability thresholds on a standalone basis, but the Group as a whole does not. The detailed rules will be released at a later date.

Our observations: The definition of 'Group' under Amount A appears narrower than that under the Pillar Two Global Anti-Base Erosion (GloBE) Rules, the latter of which also includes entities excluded from the Consolidated Financial Statements in certain circumstances.

Global revenue test

A Group meets the global revenue test if its Total Revenues for a Period are greater than EUR 20 billion⁵. A 'Period' refers to a reporting period with respect to which the UPE of a Group prepares Consolidated Financial Statements. The revenue threshold will be adjusted proportionately where the Period is more or less than 12 months.

'Total Revenues' is determined based on the revenues reported in a Group's Consolidated Financial Statements, subject to adjustments for dividends, equity gain or loss, restatements and revenues from Excluded Entities. An adjustment to account for the Group's share of revenues from joint ventures is also required.

The consultation document notes that the Task Force on the Digital Economy (TFDE) is exploring whether the Total Revenues of a Group should also be subject to the prior period test and average test, similar to those under consideration for the profitability test as discussed below.

Profitability test

If the global revenue test is met, a Group must apply the profitability test to determine if the Pre-Tax Profit Margin of the Group is greater than 10%:

- (i) in the current Period (the period test);
- (ii) in at least two of the four prior Periods (the prior period test); and
- (iii) on average across those four prior Periods and the current Period (the average test).

Based on the current draft, the prior period test and average test are applied permanently on a rolling basis. However, the consultation document notes that this is an open issue and discussions at the TFDE are ongoing with regard to whether these tests could, alternatively, apply solely as an 'entry test' in situations where a Group has not previously met the scope thresholds but, once met, the prior period test and average test would no longer apply to that Group in later Periods.

Our observations: In the World Economic Forum recently held in Davos, the OECD secretary-general said that there would likely be a one-year delay in the implementation of Pillar One until 2024. With this updated timeline, the look-back period for purposes of the prior period test and average test (for either or both of the global revenue test and the profitability test) would cover 2020, 2021, 2022 and 2023 (and also 2024 under the averaging test).

Extractives Exclusions under Amount A

Revenues and profits from Extractive Activities are excluded from the scope of Amount A. The exclusion applies where a Group both (1) derives revenue from the exploitation of Extractive Products (the product test) and (2) has carried out the relevant Exploration, Development or Extraction (the activities test). This means, for example, that revenue from commodity trading only (without having conducted the relevant extractive activity), or revenue from performing extraction services only (without owning the Extractive Product) will not qualify for the exclusion. The consultation document sets out a seven-step approach that a Group qualified for the Extractives Exclusion should follow to apply Amount A as a whole.

Regulated Financial Services Exclusion under Amount A

Revenues and profits from RFIs are excluded from the scope of Amount A. There are seven types of RFIs defined in the consultation document:

- Depository Institution
- Mortgage Institution
- Investment Institution
- Insurance Institution
- Asset Manager
- Mixed Financial Institution
- RFI Service Entity (a service entity that exclusively performs functions for an RFI)

The definition for each type of RFI generally contains three elements, all of which must be satisfied: (1) a licensing requirement, (2) a regulatory capital requirement and (3) an activities requirement. Where an entity meets the definition of an RFI, its revenues and profits will be wholly excluded from Amount A.

Similar to the Extractives Exclusion, a Group qualified for the Regulated Financial Services Exclusion should follow a seven-step approach to apply Amount A as a whole.

Our observations: The consultation document highlights that some Inclusive Framework members hold the view that reinsurance and asset management should not be excluded from Amount A. As this is not a matter for the OECD Secretariat, the consultation does not go into any further detail on this point.

The takeaway

There continue to be many unresolved issues and policy decisions for Amount A that still need to be addressed. The consultation documents note that discussions are ongoing within the TFDE on many aspects of these rules, and that the practical application of these rules will be elaborated in a future commentary probably after taking into account stakeholder input on various aspects of these rules, including in particular whether the prior period test and average test under the scope rules should apply as an initial 'entry test' or permanently on a rolling basis. Affected businesses should keep a close eye on further details coming up.

Endnotes

1. The relevant public consultation documents can be accessed via these links:
<https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-scope.pdf>
<https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-extractives-exclusion.pdf>
<https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-regulated-financial-services-exclusion.pdf>
2. The OECD released the draft Model Rules on (1) revenue sourcing and nexus and (2) tax base determinations of Amount A in February 2022. For details, please refer to our *International Tax News Flashes* issued in February and March 2022, which can be accessed via these links:
<https://www.pwccn.com/en/tax/publications/intl-tax-newsflash-feb2022-2.pdf>
<https://www.pwccn.com/en/tax/publications/intl-tax-newsflash-mar2022-4.pdf>
3. The relevant *PwC Global Tax Policy Alerts* can be accessed via these links:
<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-public-consultation-on-p1-draf-rules-for-domestic-leg.pdf>
<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-issues-public-consultation-document-on-pillar-1-amount-a.pdf>
<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-public-consultation-on-p1-amount-a-regulated-fs-exclusion.pdf>
4. 'Excluded Entities' refer to government entities, international organisations, non-profit organisations, pension funds, certain investment and real estate investment funds, and certain entities where at least 95% of their value is owned by one of the aforementioned Excluded Entities.
5. The revenue threshold will be reduced to EUR 10 billion, contingent on successful implementation (including of tax certainty on Amount A), with the relevant review beginning seven years after the agreement comes into force, and the review being completed in no more than one year.

Let's talk

For a deeper discussion of how this impacts your business, please contact:

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