# OECD released Pillar One draft Model Rules on tax base determinations of Amount A

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Issue 3

## In brief

On 18 February 2022, the Organisation for Economic Co-operation and Development (OECD) released the draft Model Rules on the tax base determinations of Amount A under Pillar One of Base Erosion and Profit Shifting (BEPS) 2.0[1] for public consultation (with comments due on 4 March 2022). This is the second[2] in a series of up to 13 so-called 'building blocks' for Amount A that the OECD is expected to release for public consultation over the coming months[3].

## In detail

### Background

Under Pillar One, a formulaic share (Amount A) of the consolidated profit of in-scope multinational enterprises (Covered Groups) will be reallocated to market jurisdictions where sales arise. The profit to be reallocated to market jurisdictions will be calculated as 25% of the profit before tax, after making a number of book-to-tax adjustments, in excess of 10% of revenue.

The OECD plans to publicly consult in respect of the Pillar One Amount A draft Model Rules in stages. The second set of draft rules covers the tax base determinations of Amount A (i.e. the computation of the profit or loss of Covered Groups that will be used for the calculation of Amount A). Based on the public consultation document, discussion is still ongoing for various components of the tax base determinations, such as the introduction of time limitations to the utilisation of losses carried forward and the scope exclusions for regulated financial services. The tax base determinations rules for Covered Groups that are subject to segmentation for Amount A purposes will be released at a later date. The document to which this alert refers is therefore a representation of the work of the OECD Secretariat.

### Tax base determinations

As Amount A will be determined based on the profit of a group (rather than on a separate entity basis), the computation of the Amount A tax base will start from the bottom-line profit or loss figure set out in the consolidated financial statements of the ultimate parent entity (i.e. items reported as other comprehensive income will be excluded). The consolidated financial statements are required to be audited and prepared under the International Financial Reporting Standards (IFRS) or equivalent financial accounting standards, such as the Hong Kong Financial Reporting Standards (HKFRS).

The following adjustments[4] will then be made to arrive at the Amount A tax base:-

**1. Book-to-tax adjustments**

The following income or expenses included in the consolidated profit or loss will be reversed:-

(i) Tax expense or tax income (including current and deferred income tax expense or income);
(ii) Dividends or distributions received or accrued in respect of an ownership interest;
(iii) Equity gain or loss (such as gain or loss arising from the disposition of an ownership interest, change in fair value of an ownership interest); and
(iv) Policy disallowed expenses (such as bribes, kickbacks, fines and penalties).

On item (iii) above, the consultation document notes that the treatment of gain or loss associated with the disposal of equity interests is still under discussion within the Inclusive Framework (IF). Amendments may be required to deal with the difference in treatment between disposal of equity interests and asset interests.

***Our observations:***

- While the Amount A tax base is intended to resemble the tax base of Pillar Two Global Anti-Base Erosion (GloBE) rules, there are clearly fewer adjustments in calculating the Amount A tax base (e.g. no adjustments for pension, stock compensation or foreign exchange differences).

- The draft Model Rules have not addressed (i) whether or how minority interests should be accounted for in computing the Amount A tax base, and (ii) the issues around computing the tax base for dual-headed Covered Groups that are listed on different stock exchanges.

**2. Restatement adjustments**

Subject to certain limitations, restatements of accounting income for prior year(s) would be reflected in the tax base for the period in which the restatement is identified and recognised. The current draft proposes a cap on the restatement adjustments that can be made in a period (i.e. not exceeding 0.5% of the revenues of the Covered Group in that period). The level of the cap will be subject to further analysis to balance the competing objectives of simplicity and avoidance of excessive single-year impacts.

**3. Deduction of losses carried forward**

Unrelieved losses of a Covered Group incurred in a prior period (Net Losses) will be carried forward and offset against any subsequent profit of the group, following an 'earn-out' mechanism. Specific rules apply in a number of instances, such as for (i) pre-implementation losses (i.e. Net Losses incurred prior to the introduction of Amount A), and (ii) losses transferred following certain types of defined business reorganisations. The introduction of time limitations to the utilisation of Net Losses is still under discussion within the IF.

***Our observations:***

- With respect to the loss carry-forward regime, the Pillar One Blueprint[5] released in October 2020 raised the issue of whether it should apply exclusively to economic losses or be extended to cover 'profit shortfalls' (i.e. in cases where the profit of a group or segment falls below the profitability threshold of Amount A, whether the difference should be treated as a 'loss' that can be carried forward for Amount A purposes). Notably, the draft Model Rules do not include a 'profit shortfall' approach.

## The takeaway

There are still many unresolved issues and policy decisions on the tax base determinations of Amount A that need to be addressed. As noted in the public consultation document, stakeholder input is specifically requested on almost all aspects of these rules. Further, these rules will need to be revisited once other aspects of Amount A become clear, such as the segmentation requirements and the extent of scope exclusions for regulated financial services.

These draft Model Rules effectively introduce another tax base calculation system that will need to be administered in the future. Multinational enterprises (MNEs) that are within the scope of both Pillars One and Two will be required to perform a number of calculations at both group and entity levels as well as on a country-by-county basis. Further clarification will be needed on the interactions between the two pillars, and in particular how their bases differ.

The rules of Pillars One and Two (including their interaction) are complex and will require enormous time and effort in terms of implementation, administration and compliance, which calls into question whether the stated goal of making the rules operational by 1 January 2023 can be achieved. Affected MNEs should keep a close eye on further details coming up, including the draft Model Rules on other aspects of Pillar One, the final Model Rules and the explanatory Commentary. Please stay tuned for the upcoming PwC Global Tax Policy Alerts.

## Endnotes

1. The draft Model Rules on the tax base determinations of Amount A can be accessed via this link: https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-tax-base-determinations.pdf

2. The first set of Pillar One draft Model Rules released by the OECD covers the revenue sourcing and nexus of Amount A. For details, please refer to our *International Tax News Flash – Hong Kong, February 2022, Issue 2*, which can be accessed via this link: https://www.pwccn.com/en/tax/publications/intl-tax-newsflash-feb2022-2.pdf

3. The OECD organised a webinar on 21 February 2022 in respect of the recent and upcoming developments in its international tax agenda. The presentation slides can be accessed via this link: https://www.oecd.org/tax/presentation-oecd-tax-talks-february-2022.pdf

4. For a more detailed discussion of the adjustments, please refer to the *PwC Global Tax Policy Alert, 22 February 2022*, which can be accessed via this link: https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-launches-public-consultation-on-pillar-1-draft-model-rules.pdf

5. The Pillar One Blueprint can be accessed via this link: https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm

## Let's talk

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