

## International: Pillar One - Draft model rules for Extractives Exclusion published

OECD releases public consultation document on first Amount A exclusion

### In brief

On 14 April 2022, the OECD released a new public consultation document with respect to the **Extractives Exclusion** for Amount A. This consultation was announced in the consultation document on the draft model rules on **Scope**, which was the subject of our last [client alert](#). The latest consultation document, the fourth of its kind for Amount A, lays out the rules to be followed by MNE groups operating in the Extractives Industry. On 4 February 2022, the OECD issued its first extensive publication on Amount A covering the two components **Nexus and Revenue Sourcing**, followed by the consultation paper on **Tax base determination** two weeks later, both of which we discussed in previous [client alerts](#) covering Pillar One's Amount A. It should be noted that, as for the previously released draft model rules, the latest publication is a work-in-progress and subject to changes. The OECD welcomes comments from the public before 29 April 2022, following which a more detailed commentary on a number of technical items is expected to be released.

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### Comments

- Amount A is proposed to come into effect in 2023 and will apply to MNE groups with a global turnover above EUR 20 billion (or local equivalent) and profitability above 10%, subject to some exceptions.
- **Extractives** and **Regulated Financial Services Activities** will be excluded from the scope of Amount A. The consultation document defines **Extractive Activities** in Schedule F. **Regulated Financial Services** will be defined in a forthcoming Schedule G, a publication that we are also eagerly awaiting.
- The definition of **Extractives Activities** contains a "product test" and an "activities test". Both must be satisfied for the activities to be deemed excluded for Amount A purposes.
- Schedule F of the draft model rules provides an overview of the seven steps that an MNE, operating in the Extractive Industry must potentially follow. Out of these seven steps, steps 2 and 3 outline the Extractives Exclusion.
- It is important to note that public feedback is requested only on the Extractives Exclusion, i.e., steps 2 and 3.

MNE groups operating in the Extractive Industry are well-advised to start familiarizing themselves with the draft model rules on the **Extractives Exclusion** of Amount A to determine whether and how Amount A will apply. A more detailed analysis will be required once the model rules have been finalized and complemented by the explanatory commentary.

### In depth

The Model Rules will serve as the basis for the substantive provisions that will be included in the Multilateral Convention, which is intended to implement Amount A, as well as provide a template that jurisdictions could use as the basis to give effect to the new taxing rights over Amount A in their domestic legislation.

The draft model rules, subject to consultation, cover Schedule F, **Extractives Exclusion**. The current draft does not reflect the final views of the Inclusive Framework (IF) members at this stage and is a working document released by the OECD Secretariat for the purpose of obtaining input from stakeholders.

The **Extractives Exclusion** draft model rules are required to determine the applicability of Amount A for taxpayers operating in the Extractive Industry. An explanatory commentary is yet to be released to further complement the model rules.



The rules concerning the **Extractives Exclusion** can be summarized as follows:

- An MNE Group (hereafter: "**Group**") operating in the sector should, as a first step, apply the general scope rules for Amount A. These scope rules include the EUR 20 billion (or local equivalent) revenue and 10% profitability tests, as described in our previous [client alert](#).
- As a second step, the Group must re-determine whether the EUR 20 billion revenue threshold is met, by only considering revenue generated from "non-Extractives Activities". If the revenue generated by such activities exceeds EUR 20 billion (or local equivalent), the Group must then continue to the third step. If the revenue generated by in-scope activities does not exceed EUR 20 billion or local equivalent, the Group is not in scope of Amount A.
- If the revenue threshold is still met, as a third step the Group must determine whether the profitability threshold of >10% is met. Revenue and related profits generated from Extractives Activities must again be excluded from this test, and only in-scope revenue and related profits must be examined. Work on this step is still ongoing at the OECD IF to determine (1) whether a transition period is needed and (2) to simplify the **Extractives Exclusion** for groups that consistently meet the revenue threshold, in step 2 above, but not the profits threshold.
- Where the Group meets both the revenue and the profitability thresholds and so falls within the scope of Amount A, the Group should continue to the fourth step, which is applying the rules for nexus and revenue sourcing. These model rules were released on 4 February 2022 and an overview of these rules is available [here](#).
- In step 5, the rules to determine and allocate profit to the respective market jurisdictions for the respective period must be applied. The full model rules in this area, in particular relating to the Marketing and Distribution (M&D) profits **safe harbour**, have not yet been released and are still pending at the time of this publication. However, it is important to note that the profits that are covered by the **Extractives Exclusion** will also be excluded for the purposes of applying the M&D profits *safe harbour*.
- Another noteworthy element is listed in step 6: the elimination of double taxation. Importantly, profits generated from activities covered by the **Extractives Exclusion** will not be subject to the provisions of the mechanism to eliminate double taxation. A particular point of interest here is that consultation feedback has only been requested on steps 2 and 3 and not on step 6. Hopefully, this will therefore be a topic on which feedback is invited during the consultations on **Tax Certainty for Issues Related to Amount A or Elimination of Double Taxation**.
- The seventh and final step is the filing of the necessary administration and reporting documentation. This step will be covered by the draft model rules on **Tax Certainty**.

In addition, the draft model rules include definitions of a number of terms used including Extractive Activities, Extractive Product, Exploration, Extraction, Development, and Qualifying Processing, among others. Below, we discuss steps 2 and 3 in more detail.

### Step 2: Subtracting revenue derived from **Extractives Activities**

The subtraction of revenue derived from **Extractives Activities** is proposed to be relatively simple: only third-party revenue derived from **Extractives Activities** is subtracted from the consolidated Group revenue. While the rule is intended to be easy to apply and document, thereby reducing the compliance burden, it is recognized that third party revenue for **Extractives Activities** as defined may not be identifiable by the Group, for example because there is only intra-group revenue at the defined point of scope of exclusion. In such case, the Group cannot subtract such revenues and must immediately proceed to step 3.

The definition of **Extractives Activities** contains two tests, both must be met for the activities to be deemed to be "excluded **Extractives Activities**". The first test is the "product test", i.e., the Group must sell an Extractive Product. The second test is the "activities test", i.e., the Group must conduct the exploration, development or extraction to obtain such product. As a result, as an example, revenue from commodity trading (only) is therefore not included in the **Extractives Exclusion** and such revenue is considered in-scope revenue for Amount A purposes.

### Step 3: Identifying the profit margin of in-scope revenue

The third step is proposed to be two-fold:

1. Groups that exceed EUR 20 billion of in-scope third party revenue, (or cannot identify third-party revenue) after the application of Step 2, will firstly need to identify the profits derived from *Extractive Activities* and exclude such profits from the Amount A tax base.



2. The Group must then determine whether the remaining profit derived from in-scope activities exceeds the profit margin of > 10%.

### Identifying the profit margin of in-scope revenue using the Disclosed Operating Segment Approach ("DOS Approach")

The Group may use the DOS Approach if there are disclosed segments in the Consolidated Financial Statements, and this approach is then simplified if the revenues in the segments either produce predominantly in-scope revenue, or predominantly excluded revenue. The Group must therefore be able to sufficiently identify whether the relevant operating revenue is derived from **Extractives Activities** or not to use this approach.

Furthermore, the cost allocation between the segments must be appropriate and reliable, including full allocation of any costs that are not allocated in the disclosed Financial Statements segments such as Corporate costs.

An operating segment generates "predominantly" excluded revenue, if at least [75%-80% - to be determined] of its total revenue is derived from **Extractives Activities**. This is referred to as the "predominance test". A cap of [EUR 1 billion - to be determined] per segment for in-scope revenue is also introduced. This means that if an operating segment generates at least [75%-80%] from its total revenue from excluded activities, and its in-scope revenue is below [EUR 1 billion] or local equivalent, the entire operating segment is considered to be "excluded". If an operating segment generates "predominantly" in-scope revenue (i.e., more than [75%-80%]), the operating segment is an in-scope segment. The in-scope revenue for such a segment is calculated by subtracting the revenue generated from **Extractives Activities** from the total segmental revenue. However, the margin of the whole of this in-scope segment is used as a proxy to calculate the profit attributable to the in-scope revenue.

In addition to the above in-scope segments and excluded segments, the model rules identify "mixed segments," which do not meet the predominance test, but are still considered in-scope. Additional supported cost allocations between in-scope and excluded parts of the mixed segment must be carried out to determine in-scope profits.

Finally, under this approach, in-scope portions of disclosed operating segments are combined to calculate relevant revenue and profit margin measures.

### Identifying the profit margin of in-scope revenue using the entity-level approach

The DOS Approach appears to be the preferred approach. However, when a Group does not disclose such segments or cannot accurately delineate expenses or revenue across segments, the Group must use an entity-level approach.

The entity-level approach is, generally, similar to the DOS Approach, with the main difference being that the predominance test and [EUR 1 billion] cap are calculated on an entity level, rather than an operational segment level.

If an entity generates at least [75%-80%] of its total revenue from **Extractives Activities** and its in-scope revenue does not exceed [EUR 1 billion] or local equivalent, the entire entity is considered excluded under the **Extractives Exclusion** rules.

However, for any entity that does not meet the above exclusion threshold, that entity is automatically in-scope. Revenue generated from excluded activities is subtracted from the total revenue for the purposes of Amount A tax base calculations. Financial results of all in-scope entities are then combined, and a deemed segment created for the in-scope activities of the combined entities, including full cost allocations.

### Reapplication of profitability test

Once the Group has identified the relevant combined profits of in-scope elements of operating segments or entities, the Group will need to verify whether the combination has a profit margin of at least 10%.

If the profit margin of the in-scope revenues is higher than 10%, the residual profits are in scope of Amount A. Note that the prior period and average profits rules also need to be applied, as well as considering the use of carry forward losses. Further thought is being given as to how to deal with these very informationally challenging issues in the context of the bespoke segmental / entity approach.

## Outlook

The OECD will collect public comments on the **Extractives Activities** draft model rules up until 29 April 2022. It is then expected that more detailed commentary on a number of technical items (**as described in this alert**) will be released.

Furthermore, the OECD has announced that it will release more details on the remaining building blocks of Amount A. The remaining building blocks of Amount A are **Profit allocation and Elimination of double taxation**. Consultations on these



building blocks are expected soon. Consultations on proposed Schedule G, the exclusion for **Regulated Financial Services**, and the **Schedule on Segmentation**, are also expected shortly.

We will continue to closely monitor and provide client alerts on these future developments around Pillar One.

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