

EXPLANATORY STATEMENT TO THE MULTILATERAL
CONVENTION TO IMPLEMENT AMOUNT A OF
PILLAR ONE

TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE
DIGITALISATION OF THE ECONOMY

Cover Note

The Inclusive Framework's Task Force on the Digital Economy (TFDE) has approved the publication of a text of the Multilateral Convention (MLC) to implement Amount A, together with its Explanatory Statement (ES) and the Understanding on the Application of Certainty for Amount A of Pillar One (UAC). This text reflects the consensus achieved so far among members on the technical architecture of Amount A, with different views on a handful of specific items noted in footnotes by a small number of jurisdictions who are constructively engaging to resolve differences.

In view of the significance of this reform for the international tax system, and guided by the 11 July 2023 Outcome Statement approved by 138 members of the Inclusive Framework, the publication of this document is intended to: ensure transparency; facilitate the ability of some members of the Inclusive Framework to engage in internal processes necessary to enable swift adoption by the TFDE; facilitate resolution of remaining differences by the Inclusive Framework; and prepare the MLC for signature.

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Background

1. The Multilateral Convention to Implement Amount A of Pillar One on the Tax Challenges Arising from the Digitalisation of the Economy¹ is the outcome of work conducted by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting.
2. The BEPS Action Plan² was developed by the Organisation for Economic Cooperation and Development (OECD) Committee on Fiscal Affairs (CFA) and endorsed by the Group of Twenty (G20) Leaders in September 2013.³ It identified 15 actions to address base erosion and profit shifting (BEPS) in a comprehensive manner, and set out deadlines to implement those actions.
3. The Task Force on the Digital Economy (TFDE), which at the time was a subsidiary body of the CFA in which non-OECD G20 countries participated as Associates on an equal footing with OECD countries, was established in September 2013 to develop a report identifying issues raised by the digital economy. This report formed Action 1 of the BEPS Action Plan and was to “Address the tax challenges of the digital economy”. Action 1 had the objective of examining the main difficulties that the digital economy poses for the application of existing international tax rules and to develop detailed options to address those difficulties.
4. After two years of work, the CFA, including all OECD and G20 countries working on an equal footing, produced the Final BEPS Package, which was endorsed by the OECD Council and the G20 Leaders in November 2015. The Action 1 Report identified a number of BEPS-related challenges presented by the digital economy, as well as broader tax challenges. The Action 1 Report concluded that work on the issues associated with the digital economy should be continued.
5. Following the delivery of the 2015 BEPS package and a call from the G20 to engage an even broader range of countries in the implementation of the measures, the OECD/G20 Inclusive Framework on BEPS (IF) was established in June 2016. The IF brought together all interested and committed countries and jurisdictions on an equal footing. With the establishment of the IF, a further mandate for the TFDE was agreed in January 2017, including for the delivery of an interim report by the end of 2018 and a final report in 2020.
6. In March 2017, the G20 called on the TFDE to deliver an interim report by the 2018 IMF/World Bank Spring Meetings – a request that was reiterated by the G20 Leaders at their July 2017 Hamburg Summit. The TFDE delivered “Tax Challenges Arising from Digitalisation – Interim Report 2018” in March 2018. This report included an update on developments in digital technology and business models, the individual measures taken by countries to address the broader tax challenges raised by digitalisation, and the extent of implementation and impact of the relevant Actions from the BEPS package.
7. In May 2019, members of the IF agreed a “Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy”. The Programme of Work provided instructions to the IF and its technical working groups to deliver a solution to the tax challenges presented by the digitalisation of the economy, focussing on two pillars. The first pillar (“Pillar One”) considered the

¹ The footnotes in the Multilateral Convention (MLC) contain objections that have been raised by some countries to certain provisions of the MLC. These objections also apply to the relevant parts of this Explanatory Statement.

² <https://www.oecd.org/ctp/BEPSActionPlan.pdf>.

³ <http://www.g20.utoronto.ca/2013/2013-0906-declaration.html>.

allocation of taxing rights and sought a coherent and concurrent review of the profit allocation and nexus rules. The second pillar (“Pillar Two”) was about an approach to addressing remaining BEPS issues.

8. In November 2019, the OECD Secretariat held a public consultation on a Secretariat proposal called the “Unified Approach” under Pillar One. This led to a “Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy” in January 2020. The Statement outlined an outline of the architecture for the Unified Approach, as agreed upon by the IF, and also a revised Programme of Work.

9. In October 2020, the IF approved the release of “Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint” for public comment. This Secretariat report focused on new nexus and profit allocation rules, and reflected the various views of IF members on potential ways forward with respect to key policy features, principles and parameters - some of which were substantially altered in subsequent negotiations. It also identified the remaining issues to be resolved, and next steps.

10. This report was followed on 1 July 2021 by a “Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy”. This Statement set out the agreed key components of the two-pillar solution, including Pillar One, and was agreed by 134 members of the IF (at 31 August 2021). The Statement provided that Amount A, under which a share of residual profit would be allocated to market jurisdictions using a formulary approach applied at the level of an MNE group (or segment), would be delivered through a multilateral instrument.

11. The July Statement was further updated in October 2021 (“the October 2021 Statement”). The October 2021 Statement, which has been agreed by 139 member jurisdictions, contained a Detailed Implementation Plan, confirming that Amount A would be implemented through a Multilateral Convention (“MLC”, or “Convention”) and, where necessary, correlative changes to domestic law.

12. The Detailed Implementation Plan said that the MLC would introduce a multilateral framework for all jurisdictions that join, regardless of whether a tax treaty currently exists between those jurisdictions. It also said that the MLC would contain the rules necessary to determine and allocate Amount A and eliminate double taxation, as well as the simplified administration process, the exchange of information process and the processes for dispute prevention and resolution in a mandatory and binding manner between all jurisdictions, with the appropriate allowance for those jurisdictions for which an elective binding dispute resolution mechanism applies with respect to issues related to Amount A.

13. According to the Detailed Implementation Plan, the MLC would ensure consistency and certainty in the application of Amount A and certainty with respect to issues related to Amount A. It provided that where a tax treaty exists between parties to the MLC, that tax treaty will remain in force and continue to govern cross-border taxation outside Amount A, but the MLC would address inconsistencies with existing tax treaties to the extent necessary to give effect to the solution with respect to Amount A. The Detailed Implementation Plan further said that the MLC would also address interactions between the MLC and future tax treaties. Where there is no tax treaty in force between parties, the MLC would create the relationship necessary to ensure the effective implementation of all aspects of Amount A.

14. The October 2021 Statement further provided that the MLC would also require all parties to remove all digital services taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future.

15. Finally, the October 2021 Statement provided that the MLC would be supplemented by an Explanatory Statement that would describe the purpose and operation of the Amount A rules and processes.

16. The MLC was negotiated by the TFDE, the members of which participated on an equal footing, and was approved by members of the IF. The text of this Explanatory Statement to accompany the MLC was prepared by the participants in the TFDE to provide clarification of the approach taken in the MLC and how each provision is intended to apply. It therefore reflects the agreed understanding of the negotiators with respect to the MLC. The TFDE adopted this Explanatory Statement on [DD MM YYYY] at the same time as adopting the text of the MLC. It is intended by the negotiators to form part of the context of the MLC, as that term is used in customary international law,⁴ for the purpose of the interpretation of its terms.

17. Also on [DD MM YYYY], the TFDE adopted an Understanding on the Application of Certainty for Amount A of Pillar One (“UAC”). The UAC is also intended by the negotiators to form part of the context for the purpose of interpreting the terms of the MLC.

⁴ In general, and as reflected in Article 31(1) of the Vienna Convention on the Law of Treaties (VCLT), a treaty must be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in their context and in light of its object and purpose. For that purpose, as reflected in Article 31(2) of the VCLT, the context comprises, in addition to the text of the treaty itself (including its preamble and any annexes): A) any agreement related to the treaty which was made between all the parties in connection with the conclusion of the treaty; B) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

Structure and content of the Convention

18. Each Part of the Convention provides for a different aspect of the October 2021 Statement. The structure and content of the Convention is summarised as follows.

19. **Part I sets out the way in which the Convention operates, including defined terms.** It provides that, except as provided otherwise, only the Group Entities of Covered Groups are subject to the provisions of the Convention.

20. **Part II provides the scope of the Convention.** It provides the key operative definitions including the definition of a Covered Group, which is determined by the EUR 20 billion global revenue test and 10 per cent profitability threshold. This Part also provides the rules applicable to a segment of an MNE Group and the exclusions for extractives, regulated financial services, defence and autonomous domestic businesses.

21. **Part III provides for the determination of the Amount A Profit that is taxable in each Party and contains the provisions describing the tax computation for a Covered Group.** This includes the rules for allocating profit among Parties to the Convention (including the marketing and distribution profits safe harbour adjustment), the rules determining the source of a Covered Group's revenues and the revenue-based nexus test.

22. **Part IV contains the rules for the elimination of double taxation that arises from the taxation of the Amount A Profit in each Party,** including the identification of the entity or entities that are entitled to the elimination of double taxation on the Amount A Profit.

23. **Part V concerns administration, provision of tax certainty, exchange of information and international cooperation.** This includes the early certainty process, the certainty process for *related issues* (including an elective binding dispute resolution mechanism available to certain Parties), and the provisions on the exchange of information and consultations between competent authorities.

24. **Part VI contains the rules for the treatment of specific measures enacted by Parties.** This includes an obligation to withdraw the measures listed in Annex A, a definition of the measures the Parties to the MLC commit not to enact in the future and a mechanism that will eliminate allocations under Article 5 for breach of that commitment, and the treatment of specific measures in scope of tax treaties.

25. **Part VII contains the final provisions of the Convention.** This includes the requirements for signature and ratification of the Convention, including for the application of the Convention to non-State jurisdictions. In addition, this Part provides that Parties may not make any reservations against the provisions of the Convention, and also for future amendments to be made to the Convention. Part VII includes a provision permitting the Parties to convene a Conference of the Parties for certain purposes. It also covers entry into force and entry into effect of the Convention, withdrawal from, amendment to and termination of the Convention and the review process to lower the Adjusted Revenues threshold. Part VII also describes the role of the Depository of the Convention and any subsequent protocols.

26. **Annex A contains a list of existing measures subject to removal.** These listed measures must not be applied to any company under Article 38, failing which the consequences set out in Article 39 would apply.

27. **Annex B contains supplementary provisions for Article 2.** This includes the definitions of some terms used in Article 2. These include definitions related to Excluded Entities (Section 1), Adjusted Profit Before Tax of a Covered Group (Section 2), the identification of the Designated Payment Entity (Section

3), Elimination Profit (or Loss) (Section 4), Return on Depreciation and Payroll (Section 5), and the Withholding Tax Upward Adjustment (Section 6).

28. **Annex C contains supplementary provisions for Article 3.** This Annex contains Section 1 (*group mergers and demergers, internal fragmentation, dual-listed arrangements and stapled structures*), Section 2 (*regulated financial institutions*), Section 3 (*qualifying extractives groups*), Section 4 (*disclosed segments*), Section 5 (autonomous domestic business exemption) and Section 6 (defence group adjustments).

29. **Annex D provides additional detail with respect to each category of Adjusted Revenues identified in Article 7.** For example, Annex D defines the enumerated indicators and the relevant allocation keys used in applying Article 6.

30. **Annex E contains supplementary provisions for Section 1 of Part V on Administration.** This includes provisions on transition periods and simplified scope calculations.

31. **Annex F contains supplementary provisions for Section 2 of Part V on Tax Certainty for Amount A.** This includes provisions on certainty reviews, the *determination panel* to resolve disagreements, the composition of a *determination panel* and definitions relevant for Section 2 of Part V.

32. **Annex G contains supplementary provisions for Section 3 of Part V on Tax Certainty for issues related to Amount A.** These includes provisions on the statement of information and *terms of reference*, the Competent Authority agreement on mode of application, the appointment of dispute resolution panel members, the communication of information and confidentiality of dispute resolution panel proceedings, as well as the dispute resolution panel process and the costs of dispute resolution panel proceedings.

33. **Annex H contains provisions on the review process and early clarification on digital services taxes and relevant similar measures.**

34. **Annex I contains a table with points attributed to Jurisdictions for purposes of certain provisions (Articles 43, 48 and 51).**

Part I – General

Article 1 – Application and personal scope

Paragraph 1

35. Article 1 describes the scope of application of the Convention. Paragraph 1 provides that, except as provided otherwise, the provisions of the Convention apply only to the Group Entities of a Covered Group. The provision applies to persons that may not be members of a Covered Group in two circumstances. First, the provisions of Section 1 of Part VI addressing the removal and standstill of digital services taxes apply with respect to all companies. Second, Article 24 is intended to ensure that the tax certainty process is available to MNE groups seeking clarity on whether they are Covered Groups. A Covered Group is defined in Article 3. The application of the Convention is further subject to the specific conditions defined in paragraph 2.

Paragraph 2

36. Paragraph 2 provides that the Convention has no implications beyond those listed in subparagraphs (a) through (c). This means the Convention cannot create any new or additional charge or liability for a member of a Covered Group in a Party that would not otherwise have arisen. This applies broadly to any charges in such Jurisdiction, including direct and indirect taxes (national or local taxes), customs duties, local taxes, and social security contributions. For example, the fact that a Group Entity is liable to tax in a Party pursuant to the Convention cannot cause that Group Entity to be deemed to have a presence in that Party such that it is liable also for social security taxes or contributions.

37. The first of the circumstances, found at subparagraph (a), is the determination of whether an MNE Group is a Covered Group and the determination of the taxation of a Covered Group in accordance with Parts II through IV. As noted in the Commentary to paragraph 1, inclusion of the identification of a Covered Group helps ensure that MNE Groups are able to make use of the tax certainty process contained in the Convention in order to clarify whether they are a Covered Group, even if it is subsequently determined that the MNE Group is not a Covered Group. The Convention also applies to determine the amount of a Covered Group's profit, the amount of that profit that may be taxed by a Party and the identification of the Group Entity or Entities that are liable for that tax, the amount of relief from double taxation that a Party must provide, and the Group Entity or Entities entitled to that relief.

38. The second of the circumstances, found at subparagraph (b), is the administration, provision of tax certainty, and exchange of information and international cooperation in accordance with Part V. The provision of tax certainty covers the mechanisms provided for by Part V, including the *tax certainty framework* and the certainty process for *related issues*.

39. The third circumstance, found at subparagraph (c), is the treatment of specific measures enacted by Parties in accordance with Part VI, which includes the removal of the measures listed in Annex A, a definition of *digital services tax or relevant similar measure* and a mechanism that will eliminate allocation under Article 5 for those Parties where a measure is in force and in effect, as well as the treatment of specific measures in scope of tax treaties.

Part II – Definitions

Article 2 – General definitions

40. Part II contains the definitions of a number of terms used throughout the Convention. With the exception of the term “Covered Group,” terms used in multiple places in the Convention generally appear in Article 2, in alphabetical order. Certain terms used in Article 2 are supplemented by additional detail in Annex B. As a general matter, terms defined in Part II are those that are used in multiple Articles throughout the Convention, and appear with the first letters of each word capitalized. Where terms are used exclusively or almost exclusively within a specific Article or Part, however, they are generally defined in that Article or Part. For ease of reference, references to these terms appear in *italics*.

41. Any term that is not defined in the Convention shall be interpreted in good faith in accordance with its ordinary meaning in its context and in the light of the Convention’s object and purpose, consistent with the principles of customary international law. The context comprises the provisions of the Convention, including its preamble and Annexes, as well as this Explanatory Statement and the UAC, which reflect the agreed understanding of the negotiators with respect to the Convention.

Acceptable Financial Accounting Standard

42. The term “Acceptable Financial Accounting Standard” means the International Financial Reporting Standards (IFRS), including IFRS as adopted in Regulation (EC) No. 1126/2008, as amended, and IFRS as adopted by the body with legal authority in the relevant Jurisdiction to prescribe, establish, or accept accounting standards for financial reporting purposes. It also includes the Generally Accepted Accounting Principles (GAAP) adopted for financial reporting purposes by the relevant legal authorities of Australia, Brazil, Canada, Member States of the European Union, Member States of the European Economic Area, Hong Kong (China), Japan, Mexico, New Zealand, the People’s Republic of China, the Republic of India, the Republic of Korea, Russia, Singapore, Switzerland, the Republic of Türkiye, the United Kingdom, and the United States of America. GAAP of another Jurisdiction is included within the definition of ‘Acceptable Financial Accounting Standard’ in the event that the Conference of the Parties issues a decision confirming that such Jurisdiction’s GAAP are equivalent to IFRS. The Conference of the Parties will determine equivalence by benchmarking each of the Jurisdiction’s standards against the corresponding IFRS standard, and by assessing the potential effect of any divergence observed in the computation of the Adjusted Profit Before Tax. This assessment should be comprehensive and not limited to considerations of a particular Group. In conducting its assessment, the Conference of the Parties will regard the determinations of the IASB or any other relevant accounting authority.

Adjusted Profit Before Tax

43. This definition refers to the meaning assigned to it in Annex B Section 2(1). Relevant explanatory statement text can be found in paragraph 1080 onwards.

Adjusted Revenues

44. This definition relies on items of income included in revenues as determined by Acceptable Financial Accounting Standards, as defined in subparagraph (a), with the exception of those items discussed. There are five steps to arrive at the Adjusted Revenues.

45. First, the starting point for the calculation of Adjusted Revenues is the gross revenues, exclusive of value added taxes, goods and services taxes, sales taxes, or other similar taxes on consumption (if any would be included), reported in the Group's Consolidated Financial Statements (or that would have been so reported if the Ultimate Parent Entity prepared Consolidated Financial Statements). Under some Acceptable Financial Accounting Standards, gross revenues can also be referred to as turnover, gross sales or a similar top line in the Group's Consolidated Financial Statements. Where a Group reports both gross and net revenues under an Acceptable Financial Accounting Standard, whether on the face of the profit and loss statement or in the notes to the Consolidated Financial Statements, the gross amount is the starting point for calculating the Adjusted Revenues. Where only net revenues (i.e. gross revenues minus, for example, rebates, returns or other amounts) are reported, that net amount is the starting point for calculating the Adjusted Revenues.

46. Accounting standards generally define revenues as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants, arising in the course of an entity's ordinary activities. For instance, accounting standards generally classify gains from ordinary activities as revenue and, accordingly, those are included in the definition of Adjusted Revenues. In contrast, items not classified as revenue for accounting purposes, such as gains from extraordinary activities (which may include, but not limited to equity gains and gains on sales of fixed assets received or realised as a non-operating income or extraordinary gain), interest, dividends or other operating income, are not comprised in the definition of Adjusted Revenues. For example, under an Acceptable Financial Accounting Standard the gain or loss arising from the derecognition (e.g. following a disposal) of an item of property, plant or equipment will generally be included in profit or loss when the item is derecognised and the gain shall not be classified as revenue. However, in other circumstances where, for instance, items of property, plant and equipment that were previously held for rental to others, are sold in the ordinary course of the business, then the proceeds of such assets would generally be recognised in the revenue line.

47. Second, revenues derived from the following categories are excluded to the extent they are included in the revenues reported for accounting purposes in the Group's Consolidated Financial Statements (or that would have been so reported if the Ultimate Parent Entity prepared Consolidated Financial Statements):

- dividends or other distributions referred to in Annex B Section 2(1)(a)(ii); and
- gain, profit, or loss referred to in Annex B Section 2(1)(a)(iii).

48. The items referred to in the above paragraph are ordinarily not included in revenues under an Acceptable Financial Accounting Standard, but the adjustments seek to cover the exceptional cases where they are included per an Acceptable Financial Accounting Standard.

49. Revenue related to items under Annex B Section 2(1)(b)(iii) is allocated evenly among the Period in which the disposition occurs and the four subsequent Periods to the extent they are included in the revenues reported in the Period. For the avoidance of doubt, the adjustment for revenue related to items under Annex B Section 2(1)(b)(iii) can only be downward in the Period in which the disposition occurs and does not require any inclusion of amounts that are not reported as revenues in that Period. The adjustment will be upward in the four subsequent Periods, but the total of those adjustments will never exceed the initial amount that was excluded for the Period in which the disposition occurs.

50. Third, revenues derived by Excluded Entities, as defined in Article 2, are excluded to the extent they are included in revenues reported for accounting purposes in the Group's Consolidated Financial

Statements (or that would have been so reported if the Ultimate Parent Entity prepared Consolidated Financial Statements) and provided that such revenues are not already excluded. This adjustment aligns with the definition of a Group which specifically excludes an Excluded Entity and the adjustments provided under the calculation of the Group's Adjusted Profit Before Tax which similarly excludes the Entity Financial Accounting Profit (or Loss) of an Excluded Entity.

51. Fourth, restatements of one or more prior period's reported Financial Accounting Profit (or Loss) that are identified and recognised during the Period and relate to an amount(s) classified as revenue under Acceptable Financial Accounting Standards are adjusted, provided that restatement meets the definition of a *prior period adjustment* for the Period as referred to in Annex B Section 2(1)(c). The definition of a *prior period adjustment* for the Period is considered in the Explanatory Statement on Annex B Section 2 (see paragraphs 1105 through 1110).

52. As specified in the fourth step outlined above, the adjustment of revenues derived from a *prior period adjustment* of one or more prior Period's reported Financial Accounting Profit (or Loss) in the calculation of Adjusted Revenues means those amounts will be taken into account for purposes of the scoping criteria in Article 3(1), the nexus test in Article 8 and the determination of the revenue sourced under Article 7 for the Period in which the adjustment is identified and recognised. The definition of Adjusted Revenues is therefore consistent with the rule for the calculation of Adjusted Profit Before Tax in Annex B Section 2(1), which similarly provides for adjustment of prior periods in the Period for a *prior period adjustment*. This means that rather than adjusting the prior Period Adjusted Revenues for purposes of the revenue test in Article 3(1)(a), the quantum of the adjustment to the revenue line in the prior Period will be adjusted in the calculation of Adjusted Revenues for the Period in which the adjustment is identified and recognised. Depending on the nature of the item of adjustment in the prior Periods, the adjustment can be either a positive or negative amount. This means that the identification or recognition of understatement of turnover in the prior Period would increase the Adjusted Revenues in the Period in which the adjustment is identified and recognised, while the identification or recognition of overstatement of turnover in the prior Period would decrease the Adjusted Revenues in the Period.

53. Fifth, revenues derived from Joint Ventures and Joint Operations are included in the calculation of Adjusted Revenues in the same proportion as the Group's share of profit or loss derived from the Joint Operation or the Joint Venture. The definitions of a Joint Venture and a Joint Operation are provided in Article 2. In respect of a Joint Venture, this adjustment is necessary as Acceptable Financial Accounting Standards do not require revenues derived from an interest in a Joint Venture to be reported in the revenue line of Consolidated Financial Statements. Instead, Acceptable Financial Accounting Standards generally only require the reporting of the profit (or loss), i.e. revenues less expenses, arising from an interest in a Joint Venture in the Consolidated Financial Statements. Therefore, to ensure equitable treatment, revenues derived from Joint Ventures are included in the calculation of Adjusted Revenues such that these amounts are taken into account for purposes of the scope tests in Article 3(1) and (2). In order to avoid double counting for Amount A purposes, revenues derived from a Joint Venture would not be included where the Joint Venture is an Ultimate Parent Entity of another Covered Group.

54. Similarly, this paragraph requires that revenues from a Joint Operation are included to align with the Group's proportionate share of profit (or loss) derived from the Joint Operation and included in calculating the Financial Accounting Profit (or Loss). A Joint Operation will generally be accounted for on a line-by-line basis, rather than the equity method, in the Consolidated Financial Statements of the Group and the revenues derived from the Joint Operation will ordinarily reflect the Group's share of the revenues in proportion to its profit (or loss). In such a case, no adjustment will be required. However, in other instances an arrangement which meets the definition of Joint Operation may see one of the parties to the arrangement receiving all of the revenues under the contractual terms and making a balancing payment to the other party (or parties) for their share of the profits. In this case, the Consolidated Financial

Statements of the Group (or Groups) that includes the Group Entity(ies) which receives the balancing payment will not report its share of the revenues from the Joint Operation on a line-by-line basis because all the revenues are reflected by the other party. Therefore, the definition of Adjusted Revenues provides the necessary adjustment so all Groups reflect their share of revenues in proportion to the profit (or loss) of the Joint Operation to which they are entitled under the contractual terms. No adjustment for revenues derived from a Joint Operation would be made where a Joint Operation is not recognized in its Consolidated Financial Statements.

Amount A Profit

55. The term “Amount A Profit” is defined in subparagraph (d) for purposes of Article 5(1) which provides how to determine the portion of the Amount A Profit of a Covered Group that is allocated to a Jurisdiction in which a Covered Group has nexus under Article 8 for a Period. Amount A Profit is determined by the two-step process provided in subdivisions (i) and (ii). These steps are applied on a groupwide basis.

56. The first step (contained in subdivision (i)) is to identify the total *excess profits* of the Covered Group for a Period, as determined on a standardised quantitative basis for purposes of the Convention. This amount is determined by first subtracting the normal profits of the Covered Group for purposes of the Convention from the total relevant profits of the Group (i.e., the Adjusted Profit Before Tax referred in Annex B Section 2). The normal profits of the Covered Group are determined for purposes of the Convention by multiplying the Adjusted Revenues defined in Article 2(c) of the Group in the Period by 10 per cent. This normal profit is then subtracted from the Adjusted Profit Before Tax (refer Annex B Section 2) of the Covered Group and any excess Adjusted Profit Before Tax of the Covered Group above the normal profit amount is considered to be *excess profits* of the Covered Group for a Period.

57. The second step (contained in subdivision (ii)) is to multiply the *excess profits* calculated in the first step by 25 per cent. The product of this calculation reflects the portion of *excess profits* at a Group level that is available for allocation to market jurisdictions, subject to the Covered Group having nexus in those jurisdictions and any limitation resulting from the *marketing and distribution profits safe harbour adjustment* in Article 5(1)(a).

Amount A Tax Return and Common Documentation Package

58. The term “Amount A Return and Common Documentation Packages” has the meaning assigned to this term in Article 15(1). A detailed explanation can be found from paragraph 506 onwards.

Competent Authority

59. The term “Competent Authority” means any person, ministry, governmental agency or institution designated by a Party as responsible for all or part of the administration of the provisions of the Convention. Partial designations could either refer to certain parts of the Convention, such as the tax certainty process or the exchanges of information under Article 39, or apply to particular Jurisdictions of the Party, including those covered by a territorial extension. The list of Competent Authorities is to be notified by each Party to the Depository. The list of all designated Competent Authorities will be made publicly available by the Depository. Parties may at any time update their list of Competent Authorities by means of an updated notification to the Depository.

Consolidated Financial Statements

60. The “Consolidated Financial Statements” used to calculate “Financial Accounting Profit (or Loss)” are the financial statements prepared by the Ultimate Parent Entity in which the assets, liabilities, income, expenses and cash flows of the Ultimate Parent Entity and other Group Entities are presented as those of

a single economic entity. The Consolidated Financial Statements include the notes that are incorporated as part of these statements. In addition, to be used for purposes of the Convention, financial statements must be independently audited and must be prepared under an Acceptable Financial Accounting Standard. The term also includes, where the Ultimate Parent Entity is the sole Group Entity, the independently audited financial statements of that Entity prepared in accordance with an Acceptable Financial Accounting Standard. In cases where two or more Groups are part of the same *dual-listed arrangement* or the same *stapled structure* the Group Entities of the Groups shall be treated as Group Entities of a single Group, which will be deemed to have a single Ultimate Parent Entity, with that single Ultimate Parent Entity to be identified in accordance with Annex C Section 1(9). The Consolidated Financial Statements for that Group will be the Consolidated Financial Statements of that single Ultimate Parent Entity.

Contracting State

61. The term “Contracting State” refers to the States that have signed and ratified, accepted or approved the Convention, irrespective of whether the Convention has entered into force.

Controlling Interest

62. The definition of “Controlling Interest” uses a consolidation test (including a deemed consolidation test) to determine whether an Entity owns a Controlling Interest in another Entity. Accordingly, an Entity will have a Controlling Interest if: (i) that Entity has an equity interest that carries rights to profits, capital or reserves and is required to consolidate the assets, liabilities, income, expenses and cash flows of another Entity on a line-by-line basis in accordance with an Acceptable Financial Accounting Standard, or (ii) it would have been so required in case that the Entity had prepared consolidated financial statements in accordance with an Acceptable Financial Accounting Standard.

63. In other words, the definition relies on the existence of control, as determined under an Acceptable Financial Accounting Standard, that leads to the requirement to consolidate the assets, liabilities, income, expenses and cash flows of on a line-by-line basis. This means that for purposes of the Convention an Entity will directly or indirectly control another Entity if it is, or would be, required to consolidate the assets, liabilities, income, expenses and cash flows of that other Entity on a line-by-line basis under an Acceptable Financial Accounting Standard.

64. Further, and only for purposes of the *internal fragmentation* rule in Annex C Section 1(7), the Controlling Interest definition is broadened to also include an equity interest that leads, or would lead, to the requirement for an *investment fund* or *real estate investment vehicle* to measure its investment in an Entity at fair value through profit or loss in accordance with an Acceptable Financial Accounting Standard. This means that a Controlling Interest is recognised for purposes of these provisions where there is direct or indirect control under an Acceptable Financial Accounting Standard, such that an Entity presents its investments at fair value (instead of on a line-by-line basis) as commonly seen in the cases where an entity is an investment entity for accounting purposes.

65. This definition is also important for purposes of the definition of an Ultimate Parent Entity.

Covered Payment

66. The term “Covered Payment” defines the payments subject to withholding taxes that are taken into account for the purpose of elimination of double taxation (under Part IV) and the allocation and taxation of profits (under Part III). It operates alongside the definition of the term Covered Withholding Tax in subparagraph (j). Taken together, the terms Covered Payment and Covered Withholding Tax apply for the *withholding tax downward adjustment* in Annex B Section 4(12) and the *Withholding Tax Upward Adjustment* in Annex B Section 6. Where tax is withheld on a payment that is not a Covered Payment, or

a tax is not a Covered Withholding Tax, then such a tax will have no bearing on the allocation of Amount A Profit under Article 5 or the calculation of Elimination Profit (or Loss) of a Covered Group for a Period in a Jurisdiction for the purposes of elimination of double taxation under Articles 9 through 13.

67. The definition of the term Covered Payment is structured in two-parts. First, the chapeau in subparagraph (j) provides positive criteria that must be met for a payment to be a Covered Payment. Second, subdivisions (i) through (viii) provide certain categories of payments to be excluded from meeting the definition of Covered Payment, even in the case that such a payment satisfies the positive criteria in the chapeau.

68. The chapeau in subparagraph (j) provides a Covered Payment means income arising in a Jurisdiction and paid to a Group Entity of a Covered Group located in another Jurisdiction. The phrase “income arising in a Jurisdiction” clarifies the source of income that might potentially constitute a Covered Payment. This phrase is relevant as the definition of Covered Withholding Tax refers to “tax on income withheld by the payor in respect of a Covered Payment in the Jurisdiction where the income is arising”. Income arises in a Jurisdiction under subparagraph (j) where it is treated as arising in that Jurisdiction under its domestic law. This means that for purposes of subparagraph (j) income can be treated as arising in more than one Jurisdiction, to the extent that the domestic law of more than one Jurisdiction treats the income as arising there. Further, the phrase “income arising in a Jurisdiction” does not require that income arises in the payor’s Jurisdiction for a payment to meet the definition of Covered Payment. For instance, where the domestic law of a third Jurisdiction, other than the location of the payor or payee, treats the income as arising in that Jurisdiction, then that income would be treated as arising in that third Jurisdiction for purposes of subparagraph (j).

69. The chapeau in subparagraph (j) requires that a Covered Payment is paid to a Group Entity of a Covered Group located in another Jurisdiction. Under the chapeau, there are two conditions that a payment must meet in order for a payment to meet the definition of a Covered Payment. First, a payment must be paid cross-border such that the payor and payee are located in different Jurisdictions. Where a payment is paid to a Group Entity that is located in the same Jurisdiction as the payor (i.e. a solely domestic payment), then such a payment cannot meet the definition of Covered Payment. Second, in order for a payment to meet the definition of Covered Payment it must be paid to a Group Entity of a Covered Group. If the payee is not a Group Entity of a Covered Group, then that payment cannot meet the definition of Covered Payment. Effectively, this requirement means that any withholding tax withheld on payments to Group Entities of a Group that is not a Covered Group under Article 3 of the Convention are not taken into account for purposes of the Convention. For instance, if a payment is made to an Entity of a Group that does not meet the scope threshold stipulated in Article 3(1), or that is entitled to a scope exclusion (for example in Article 3(5) for a *qualifying extractives group*), then that payment will not be a Covered Payment, resulting in no consideration of withholding taxes on this payment. Further, the requirement in the chapeau of subparagraph (j) is that the payee is a Group Entity of a Covered Group. There is no requirement that the payor is a Group Entity of the same Covered Group or a different Covered Group. This means that payments between Group Entities of the same Group and payments from an Entity that is not a Group Entity of the same Group as the payee (for instance, a payment from an unrelated party to a Group Entity), can meet the definition of Covered Payment, so long as the payee is a Group Entity of a Covered Group.

70. As explained in paragraph 69 above, subdivisions (i) through (viii) provide that certain payments are excluded from meeting the definition of Covered Payment:

- Subdivision (i) provides that a payment to a *regulated financial institution* as defined in Annex C Section 2(3)(a) or a *segment entity of a regulated financial institution segment* as defined in Annex C Section 2(2)(l) are excluded payments. This means that where a payment is made to an Entity

that is covered by the regulated financial services exclusion, then any withholding tax withheld in respect of that payment will not be taken into account for purposes of the Convention.

- Subdivision (ii) provides that a payment to an *extractives entity* as defined in Annex C Section 3(2)(c) or a *segment entity* of an *extractives segment* as defined in Annex C Section 3(2)(d) are excluded payments. This means that where a payment is made to an Entity that is covered by the extractives exclusion, then any withholding tax withheld in respect of that payment will not be taken into account for purposes of the Convention.
- Subdivision (iii) provides that a payment related to extractives that are made to a *mixed entity* (as defined in Annex C Section 3(2)(e)), a *segment entity* of a *mixed segment* (as defined in Annex C Section 3(2)(m)), a *non-extractives entity* (as defined in Annex C Section 3(2)(r)), or a *segment entity* of a *non-extractives segment* (as defined in Annex C Section 3(2)(dd)), is an excluded payment to the extent that the payment relates to *extractives revenue*. This approach therefore follows the approach to the extractives exclusion in Annex C (Supplementary provisions for Article 3) for such Entities, which are performing both extractives and non-extractives activities, and relies on the definition of *extractives revenue* in Annex C Section 3(3)(i).
- Subdivision (iv) provides that a payment to a Group Entity located in an *autonomous domestic business jurisdiction* (as defined in Annex C Section 5(2)(a)) is an excluded payment. This means that where a payment is made to an Entity that is covered by the autonomous domestic business exemption, then any withholding tax withheld in respect of that payment will not be taken into account for purposes of the Convention.
- Subdivision (v) provides that a payment that relates to *defence revenues* as defined in Annex C Section 6(3)(c) is an excluded payment. This means that where a payment that is subject to withholding tax is covered by the *defence group* adjustment or where any intragroup payment that is related to *defence revenues* is subject to withholding tax, that withholding tax will not be taken into account for purposes of the Convention.
- Subdivision (vi) provides that dividends or other distributions paid in respect of a Specified Equity Interest that carries rights to the profits, capital or reserves of an Entity are excluded payments. This means that where a withholding tax is levied by a Jurisdiction on such payments, those payments will not meet the definition of a Covered Payment.
- Subdivision (vii) provides that a payment for the disposition of a Specified Equity Interest or of other similar interests, such as interests in a partnership or trust, that carry rights to profits, capital or reserves of an Entity are excluded payments. This means that where a withholding tax is used by a source Jurisdiction as a collection method for charging the non-resident payee to tax on a gain on the disposition of this category of interests, those payments will not meet the definition of a Covered Payment.
- Subdivision (viii) provides that if a payment to a Joint Venture or Joint Operation is otherwise in-scope of the definition of Covered Payment because it does not meet the exclusions provided in subdivisions (i) through (vii), the portion of the payment that relates to the party other than the Covered group (i.e., the third-party interest in the Joint Venture or Joint Operation) will be excluded. This exclusion reflects that the profit of a Joint Venture or a Joint Operation is only accounted for in the Consolidated Financial Statements in proportion to the Group's share and this is followed for Amount A purposes. The term Covered Payment feeds into both Withholding Tax Upward Adjustment definition and *withholding tax downward adjustment*, therefore the third-party interest in the Joint Venture or Joint Operation will be excluded in both withholding tax adjustment contexts.

Covered Withholding Tax

71. The term “Covered Withholding Tax”, which operates alongside the definition of the term Covered Payment in subparagraph (j), identifies withholding taxes that are taken into account for the purpose of elimination of double taxation (under Part IV) and the allocation and taxation of profits (under Part III). Taken together, the terms Covered Payment and Covered Withholding Tax apply for the “withholding tax downward adjustment” in Annex B Section 4(12) and the Withholding Tax Upward Adjustment in Annex B Section 6. Where a tax is withheld on a payment that is not a Covered Payment, or a tax is not a Covered Withholding Tax, then such a tax will have no bearing on the allocation of Amount A Profit under Article 5 or the calculation of Elimination Profit (or Loss of a Covered Group for a Period in a Jurisdiction for purposes of elimination of double taxation under Articles 9 through 13.

72. To define Covered Withholding Tax, subparagraph (k) refers to “a tax on income ... in the Jurisdiction in which the Covered Payment arises”, which mirrors the language in the definition of a Covered Payment in subparagraph (j), which refers to “income arising in a Jurisdiction”. As explained above, this phrase in subparagraph (k) clarifies the source of income that is potentially subject to a Covered Withholding Tax. Accordingly, the source of the income could be identified as a Jurisdiction other than the payor’s Jurisdiction under the domestic law of that other Jurisdiction, and thus the “tax on income” is not necessarily tax levied in the Jurisdiction where the payor is located. For instance, where a third Jurisdiction, other than the location of the payor and payee, treats the income as arising in that Jurisdiction under its domestic law, and obliges the payor to withhold the tax on behalf of the non-resident payee, then such a withholding tax could be a Covered Withholding Tax in the same way as the more common case where the Jurisdiction where the payor is located is identified as the source Jurisdiction where the income is arising and taxed.

73. Subparagraph (k) refers to the “tax on income withheld in a Period in respect of a Covered Payment by the payor”. Taxes on income in this context is used broadly and refers to any taxes on total income or elements of income that are generally covered by the Party’s tax treaties, as described in Commentary to Article 2 of the OECD Model or UN Model. But where a tax on income is withheld in relation to a payment that does not meet the definition of Covered Payment, then that tax on income does not meet the definition of Covered Withholding Tax. Further, the definition of Covered Withholding Tax covers a tax on income arising in a Jurisdiction whether or not that tax is calculated by reference to the gross amount of the payment, or a different amount (e.g. a lower amount or an amount after taking into account certain deductions). For instance, where a Jurisdiction taxes income arising in the Jurisdiction after taking into account an actual or notional cost of capital of the non-resident payee, then such taxes may still meet the definition of Covered Withholding Tax.

74. Subparagraph (k) uses the word “withheld” to reflect that legally a Covered Withholding Tax is a tax on income of the non-resident payee, but the obligation to collect (i.e. withhold the tax amount) falls on the payor. In instances where the obligation to collect is jointly imposed on the both the payor and another party this will be considered to be an obligation to collect of the payor for purposes of this provision.

Designated Payment Entity

75. The term “Designated Payment Entity” generally means the Ultimate Parent Entity, if it is a resident of a Party at the end of that Period. Where the Ultimate Parent Entity is not a resident of a Party at the end of the Period, however, subparagraph (l)(ii) provides that the Designated Payment Entity is identified by under Annex B Section 3. For further details see the Explanatory Statement to Annex B Section 3.

Elimination Profit (or Loss)

76. This definition has the meaning assigned to it in Annex B Section 4. A detailed explanation can be found from paragraph 1174 onwards.

Elimination Threshold Return on Depreciation and Payroll

77. The term Elimination Threshold Return on Depreciation and Payroll. The amount is calculated by multiplying the Adjusted Revenues of the Covered Group for a Period by 10 per cent and then dividing the product by the sum of the Covered Group's *accounting depreciation and payroll* for the Period. The term therefore calculates the Covered Group's Return on Depreciation and Payroll that is equivalent to a 10 per cent return on the Adjusted Revenues of the Covered Group.

78. The term is used to determine whether a *specified jurisdiction* is within Tiers 3A and 3B. The term is also used to calculate the "adjusted jurisdictional excess profits" in Article 5(2)(c).

Entity

79. The term Entity is intended to be defined broadly, and includes any juridical person or arrangement that prepares, or is required to prepare, separate financial accounts. The definition would therefore include partnerships and trusts. An individual cannot be an Entity for purposes of the Convention because an individual is not a "juridical" person.

80. The term "arrangement" should be interpreted broadly and include any agreement, transaction or series of transactions between separate parties that is legally enforceable. For instance, an organisation formed under a domestic law by individuals who adopt or agree to statutes, certificates or similar documents that define, among other things, the purpose of the organisation, the decision making-process and the contributions required from members or parties, is considered an arrangement. In contrast, a branch or place of business of an Entity situated in another Jurisdiction is not an arrangement for purposes of the definition of an Entity, even where that branch or place of business is treated as a permanent establishment in the other Jurisdiction in accordance with an applicable tax treaty in force or under domestic legislation where a Jurisdiction taxes the income attributable to such a branch or place of business on a net basis similar to the manner in which it taxes its own tax residents.

81. The definition is not based on the precise form or constitution of the juridical person or arrangement. Rather, the determining factor is whether the juridical person or arrangement prepares (or is required to prepare) financial accounts. Where the juridical person or arrangement does not prepare financial accounts, and is not required to do so, it is not regarded as an Entity for purposes of the Convention.

82. The financial accounts prepared by the juridical person or arrangement do not have to follow a specific form and there is no requirement that they are prepared under mandatory rules or procedures of a Jurisdiction. Instead, they could be prepared for financial reporting, regulatory or internal management control purposes.

Entity Financial Accounting Profit (or Loss)

83. The term "Entity Financial Accounting Profit (or Loss)" refers to the profit or loss determined for an Entity (before any consolidation adjustments eliminating intra-Group transactions) in preparing Consolidated Financial Statements of the Group. In preparing the Consolidated Financial Statements of a Group, financial statements are prepared for each Group Entity based on the same financial accounting standards and it is these financial statements that are considered for determining Entity Financial

Accounting Profit (or Loss). The relevant profit measure sourced from these financial statements is the profit or loss determined taking into account all income and expenses of the Group Entity and excluding income and expenses reported as other comprehensive income.

Entity Financial Third-party Accounting Revenues

84. The term “Entity Financial Third-party Accounting Revenues” is defined in subparagraph (q) and provides the measure of third-party booked revenues that is relevant for assessing the level of integration of the business of a Covered Group in a Jurisdiction for purposes of Annex C Section 5 (Autonomous domestic business exemption), particularly paragraph 2(a)(i) of that Section, and for purposes of *withholding tax upward adjustment reduction factor* in Annex B Section 6(4)(a)(ii). The definition identifies the revenues of an Entity determined in preparing the Consolidated Financial Statements of the Group, which includes all revenues of the Group Entity determined under the same Acceptable Financial Accounting Standards as the Financial Accounting Profit (or Loss) of the Group, after eliminating intra-Group transactions with Group Entities. Revenues derived from extractives or regulated financial services activities are not taken into account for purposes of determining the entity financial accounting revenues.

Excluded Entity

85. The term “Excluded Entity” refers to Entities that are outside the operative provisions of the Convention. Qualification as an Excluded Entity can have three practical effects:

- First, an Excluded Entity is never a Group Entity.
- Second, two types of Excluded Entity are never an Ultimate Parent Entity for purposes of the Convention: a *governmental entity* and a *pension fund* (for further details, see paragraphs 1039 through 1046 and 1066 through 1069 of this Explanatory Statement).
- Third, Excluded Entities do not have any administrative obligations provided under Part V Section 1.

86. The definition of Excluded Entity consists of two parts that apply at the same time: the first part lists the types of Entities that are Excluded Entities (see Article 2(r)(i)) and the second part in Article 2(r)(ii) extends the exclusion to Entities owned by such listed Entities provided that certain tests are met.

Subdivision (i)

87. Subdivision (i) lists the types of Entities that are Excluded Entities and therefore outside the operative provisions of the Convention. Generally, the assets, liabilities, income, expenses and cash flows of such Entities would not be consolidated on a line-by-line basis with other operating Entities under an Acceptable Financial Accounting Standard and, therefore, Excluded Entities would not qualify as Group Entities subject to the provisions of the Convention. However, for completeness and consistency, and to improve certainty of outcomes while recognising differences between accounting standards, subdivision (i) explicitly provides a list of Excluded Entities. In other words, subdivision (i) serves as a backstop to ensure that such Entities, unless explicitly stated otherwise, are not unnecessarily subject to the provisions of the Convention.

88. The Excluded Entities referred to in clauses (A) through (D) are: a *governmental entity*, an *international organisation*, a *non-profit organisation* and a *pension fund* as defined in Annex B Section 1. This is a general exclusion which applies irrespective of the position of such Entities within the chain of ownership.

89. The Excluded Entities referred to in clauses (E) and (F) are: an *investment fund* that satisfies the criteria provided in Article 2(II)(i)(A) and (B) (the definition of an Ultimate Parent Entity) and a *real estate investment vehicle* that satisfies the same criteria. This exclusion applies only if the *investment fund* or the *real estate investment vehicle* is an Ultimate Parent Entity. Otherwise, such Entities continue to be treated as a Group Entity for purposes of the Convention.

Subdivision (ii)

90. Subdivision (ii) provides an extension of the definition of an Excluded Entity that covers Entities owned by an Excluded Entity. It recognises that Excluded Entities may be required, for regulatory or commercial reasons, to hold assets or carry out specific functions through separate controlled Entities. It addresses the situation where an Excluded Entity, as defined in subdivision (i), sets up an Entity to hold its assets or invest its funds, or to carry out activities that are ancillary to the Excluded Entity's activities.

91. For example, commercial or regulatory requirements may prevent an *investment fund* from investing directly in an asset and may require the investment to be made through a separate vehicle to limit the *investment fund's* liability. The rule addresses these types of situations and may permit such a holding vehicle to qualify as an Excluded Entity.

92. In some cases, an enterprise could be composed exclusively of Excluded Entities. For example, an *investment fund* may be required to consolidate the assets, liabilities, income, expenses and cash flows of separate investment vehicles that it controls. However, if those investment vehicles all meet the conditions to qualify as an Excluded Entity, none of them can be considered a Group Entity and hence the enterprise would not be considered a Group for purposes of the Convention.

93. Subdivision (ii) does not apply if the Entity is held by a *pension services entity* (as defined in Annex B Section 1(f)). As described further in Annex B Section 1, *pension services entities* are special purpose vehicles that may perform similar functions to the Entities described in subdivision (ii). Allowing a *pension services entity* to establish a further separate controlled entity that qualified for Excluded Entity status would dilute the intended effect of the rules in subdivision (ii), which are intended to be limited to those controlled entities that carry out functions for the Excluded Entity (such as the *governmental entity*, *international organisation* or *non-profit organisation* or *pension fund* itself).

94. In order to qualify as an Excluded Entity under subdivision (ii) the Entity must meet two tests: an ownership test and an activities test.

Ownership test

95. The ownership test is set out at the beginning of subdivision (ii). Under this test, one or more Excluded Entities defined in subdivision (i)(A) through (F) must own at least 95 per cent of the value of the Entity. The 95 per cent threshold allows for situations in which there is a minority interest holder, such as where a fund manager holds a small percentage of an *investment fund*, where domestic law requires at least two shareholders to incorporate a corporation or where an Excluded Entity invests through a partnership and is required to have another Entity acting as the general partner for domestic law purposes.

96. Subdivision (ii) also applies if the Excluded Entity under subdivision (i) owns at least 95 per cent of the value of the Entity through an uninterrupted chain of Excluded Entities. For instance, A Co is an Excluded Entity under one of the subdivision (i)(A) through (F). A Co wholly owns B Co (an Excluded Entity under subdivision (ii)), which in turn owns 95 per cent of the value of C Co. In this case, C Co meets the ownership test because 95 per cent of its value is indirectly owned by A Co. In contrast, if A Co owned 95 per cent of the value of B Co in the same situation, then the ownership test is not met with respect to C Co because its value owned by A Co has been diluted to 90 per cent (95% x 95%).

97. The phrase “value of the Entity” refers to the total value of the equity interests that carry rights to the profits, capital or reserves of the Entity. In the case of shares, it refers to the value of the issued and outstanding shares that are held by shareholders. The value of the Entity is different from a direct measurement of the amount of equity interests held by the Excluded Entity which refers to the underlying rights to profits, capital or reserves of such Entity. The difference between a measurement based on “value of the Entity” and a measurement based on “equity interest” is that the former looks to the aggregate value of the equity interests held by the Excluded Entity as a percentage of the overall value of the equity interests issued by the Entity while the second one compares one or more of the specific rights (i.e. profits, capital or reserves) that are carried by the equity interest.

98. The ownership test in this paragraph is only met where 95 per cent or more of the value of the equity interests of the Entity are beneficially owned (either directly or indirectly) by the Excluded Entity. The assessment of the value should be made as of the date of the most recent change in the Excluded Entity’s relative equity interests in the Entity and should take into account the value of all the equity interests held by the Excluded Entity. For instance, a newly formed Entity issues 200 ordinary shares worth EUR 1 each and 100 preferred shares worth EUR 2 each. An Excluded Entity shareholder receives all the ordinary shares and 90 of the preferred shares. In this situation, the value of the Entity would be 400 and the Excluded Entity shareholder owns 95 per cent (380/400) of the value of the Entity for purposes of the second part of this paragraph.

99. The value of an Excluded Entity’s interest in an Entity should be measured as of the date of the most recent change in the Excluded Entity’s relative equity interests in the Entity. For example, if the Entity issues new shares to a minority shareholder/ employee as part of a compensation package, the Excluded Entities should determine whether they still hold 95 per cent of the value of the equity interests of the Entity immediately after such share issuance. However unrealised movements in the comparative value between different classes of shares should not affect the application of the test under the second part of this paragraph until there is a change in the Excluded Entity’s relative equity interests in the Entity. For example, if the value of the equity interests of the Entity in the example above fell to 300 such that the ordinary shares are now worth only 100, the Excluded Entity should still be treated as holding 95 per cent of the value of the Entity despite the fact that the total market value of its shares is 93 per cent (280/300) of the Entity as a whole.

Activities test

100. The activities test is divided into subdivision (ii)(A) and (B).

101. Clause (A) requires that the Entity operates “exclusively or almost exclusively to hold assets or invest funds.” The words “exclusively or almost exclusively” denote a facts and circumstances test that requires all or almost all of the Entity’s activities to be related to holding assets or investing funds. This language further means that in order to be an Excluded Entity under subdivision (ii), the Entity must not actively carry out activities other than holding assets or investing funds. For example, clause (A) could apply to a sovereign wealth fund owned by a government (in case it does not already meet the definition of a *governmental entity*) that is holding assets and investing funds for the benefit of the government, but it would not extend to an airline company owned by the government, because an airline’s activities go beyond holding assets and investing funds. Clause (A) also requires that the assets are held or funds invested “for the benefit of the Excluded Entity”. For example, an Excluded Entity may have a wholly owned subsidiary which borrows funds from third parties to make direct acquisitions of assets (including equity interests in operating companies). Where this is the case, the borrowing and acquisition should be treated as holding assets and investing funds for the benefit of the Excluded Entity. This condition has to be read in conjunction with the other conditions. For example, this condition is still met even if the fund manager benefits from the investments made by such Entity in proportion to its ownership percentage.

102. Alternatively, the activities test is met under clause (B) if the Entity only carries out activities that are ancillary to the activities carried out by an Excluded Entity. This alternative activities test was included because in some situations the activities that would otherwise be performed by the Excluded Entity referred to in subdivision (i) are outsourced to a separate legal Entity that is wholly-owned by the Excluded Entity (including those that are 95 per cent owned). For example, if an Excluded Entity sets up an information technology service company that provides services exclusively to the Excluded Entity, then such company would meet the requirement under subdivision (ii)(B).

103. An Entity should not be considered to fail the activities test where the aggregate of its activities falls within the combined scope of clauses (A) and (B). Accordingly, an Entity that carries out ancillary activities and the remainder of its activities are to exclusively or almost exclusively hold assets or invest funds for the benefit of an Excluded Entity or Entities will satisfy the activities test.

Existing Tax Agreement

104. The term “Existing Tax Agreement” includes any agreement that provides for the elimination of double taxation with respect to taxes on income and includes agreements that apply more broadly. For example, agreements that cover capital taxes, or taxes on capital gains, in addition to income taxes would meet the definition. The definition includes all agreements that provide for the elimination of double taxation with respect to taxes on income, regardless of their scope, and so includes comprehensive agreements and those with a more limited scope, such as those applying solely to shipping and air transport. For greater certainty, it is understood that one of the purposes of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting is the avoidance of double taxation with respect to taxes on income.

105. Paragraph 2(s)(i) and (ii) define between whom an agreement (which can be bilateral or multilateral) needs to be concluded to be treated as an Existing Tax Agreement. The first category, described by paragraph 2(s)(i), is composed of Parties to the Convention. The second category, described by paragraph 2(s)(ii), is composed of jurisdictions or territories to which the Convention applies pursuant to a declaration of territorial extension made by a Party on the basis of Article 42(1). This is intended to cover the situation of jurisdictions or territories which, under the arrangements with the State responsible for their international relations, have the ability to conclude tax agreements in their own right.

106. An agreement for the avoidance of double taxation with respect to taxes on income must be in force at the time the Convention enters into force to meet the definition.

107. It is left to each Party to determine how best to implement the MLC in its domestic legal system. As a result, this definition addresses neither arrangements between a Party and a jurisdiction or territory to which the Convention applies pursuant to a declaration of territorial extension made by the same Party, nor arrangements between two or more such jurisdictions or territories for which the same Party is responsible. Consistent with general principles of international law, however, each Party must ensure that it is able to implement the provisions of the Convention in good faith, in a manner that is consistent with its object and purpose. For instance, where a Party has chosen to impose tax on the Amount A Profits allocated to it, the tax should be consistently applied across all Jurisdictions that are subject to the Convention and should not be restricted by an arrangement with a jurisdiction or territory with respect to which the Party has made a declaration of territorial extension.

Family Member

108. The term “Family Member” is defined in Article 2(t) and includes any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, uncle, aunt, niece, nephew, mother-in-

law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law (including adoptive relationships) of an individual or any person sharing an individual's household (other than a tenant or employee). The term is used for the purpose of determining whether a person shall be considered to be "connected" to another person in Annex B Section 1(h), and whether an individual is conflicted to act in a *determination panel* or *dispute resolution panel* under Annex F Section 3(15)(b) and Annex G Section 3(f)(ii), respectively.

Financial Accounting Profit (or Loss)

109. See paragraph 1081 of this Explanatory Statement for further details.

Gross Domestic Product

110. See paragraph 345 of this Explanatory Statement for further details.

Group

111. The definition of a "Group" includes the Ultimate Parent Entity and combines a consolidation test and specific exclusions. The consolidation test is met where the assets, liabilities, income, expenses and cash flows of an Entity, as defined in Article 2(w), are included in the Consolidated Financial Statements prepared by the Ultimate Parent Entity of the Group, or would have been included if that Ultimate Parent Entity had prepared Consolidated Financial Statements. This means that an Entity that is excluded from the Consolidated Financial Statements of the Ultimate Parent Entity solely on size or materiality grounds, or on the grounds that the Entity is held for sale, does not form part of a Group.

112. The definition of a Group is broadly drawn to include a collection of Entities whose assets, liabilities, income, expenses and cash flows are included in the consolidated financial statements of the Ultimate Parent Entity, as well as the Ultimate Parent Entity. This would include a single Entity, other than an Entity that is part of another Group, an Excluded Entity, an *investment fund* or a *real estate investment vehicle*. Such an Entity would be an Ultimate Parent Entity. This approach ensures that a large stand-alone entity with a physical presence solely in its home Jurisdiction could nonetheless fall in-scope of the Convention. In such scenarios, the relevant single Entity is the Ultimate Parent Entity of the Group as well as a Group Entity, for purposes of the Convention, and the independently audited financial statements of that Entity prepared in accordance with an Acceptable Financial Accounting Standard are the financial statements prepared by the Ultimate Parent Entity of the Group. Otherwise, the rules and obligations contained in the Convention apply similarly to such single Entity.

Group Entity

113. The term "Group Entity" means any Entity, other than an Excluded Entity, that is included in a Group.

114. Any Entity (including an Ultimate Parent Entity) that is included in a Group under Article 2 because it meets the consolidation test will not be considered a Group Entity if it is an Excluded Entity. This exclusion has consequences for the application of other provisions contained in the Convention.

Joint Operation

115. The term "Joint Operation" includes an arrangement where the parties have joint control and have the right to the assets and the obligations for the liabilities relating to the arrangement. Secondly, the Ultimate Parent Entity of a Group recognises its interests in the Joint Operation in its Consolidated Financial Statement under an Acceptable Financial Accounting Standard. This means that the

consolidated financial statements reflect the Group's interest in the Joint Operation on a line-by-line basis, as opposed to the equity method as is the case for a Joint Venture. This definition draws on IFRS 11 - *Joint Arrangements*, which explains the difference with an arrangement that is a joint venture for IFRS purposes.

Joint Venture

116. The definition of a "Joint Venture" does not require the parties to the Joint Venture to have a minimum percentage of ownership. However, it requires all the parties, or a group of the parties, to the arrangement to have joint control. Though joint control generally requires the unanimous consent of all the parties with respect to decisions about the activities of the Joint Venture, the reference to joint control must be specifically considered in the context of the Acceptable Financial Accounting Standard used by the Covered Group to produce its Consolidated Financial Statements.

117. The definition requires that the profit or loss of the Joint Venture be recognised under the equity method of accounting.

Jurisdiction

118. The term "Jurisdiction" means either (i) a State or (ii) a jurisdiction or territory for whose international relations a State is responsible. The word "territory" is used in addition to "jurisdiction" in order to capture the various terms used to refer to non-State entities for whose international relations a State is responsible.

Jurisdictional Depreciation and Payroll

119. The term "Jurisdictional Depreciation and Payroll" has the meaning assigned to it under Annex B Section 5(3). Relevant explanatory statement text can be found in paragraph 1481 onwards.

Jurisdictional Return on Depreciation and Payroll

120. The term "Jurisdictional Return on Depreciation and Payroll" has the meaning assigned to it under Annex B Section 5(2). Relevant explanatory statement text could be found in paragraph 1480 onwards.

Lower Income Jurisdiction

121. The term "Lower Income Jurisdiction" is a Jurisdiction that is defined by the World Bank as a "low-income economy" or as a "lower-middle-income economy" by reference to *gross national income* per capita using the World Bank Atlas method for the most recent World Bank determination period that ends in the Period immediately preceding the Period. This term is used in the context of the "tail-end revenues" in the revenue sourcing rules (refer to Annex D Section 1(3)(b)(ii)(A), and paragraph 2208 of the Explanatory Statement), as well as in the context of the profit allocation rules, including determination of the *jurisdictional offset percentage* (refer to Article 5(2)(d), and paragraph 218 of the Explanatory Statement) and Withholding Tax Upward Adjustment (refer to Annex B Section 6 of the Convention, and paragraph 1545 of the Explanatory Statement).

122. Typically, the World Bank determinations considered for purposes of this definition are made with respect to periods beginning on 1 July and ending on 30 June in the following calendar year. On this basis, in an instance where a Jurisdiction is designated as a "low-income economy" or as a "lower-middle-income economy" for the period 1 July 2024 to 30 June 2025, and the relevant Covered Group has a fiscal year end matching to the calendar year, this World Bank determination would be relevant for the Period beginning on 1 January 2026 for the Covered Group and the Jurisdiction would be a Lower Income

Jurisdiction for that Period. If the World Bank determination for that Jurisdiction changed and it was no longer designated as a “low-income economy” or as a “lower-middle-income economy” in the World Bank determination covering the period from 1 July 2025 to 30 June 2026, that Jurisdiction would cease to be a Lower Income Jurisdiction in relation to the Covered Group for the Period beginning on 1 January 2027.

OECD Model

123. The term “OECD Model” means the OECD Model Tax Convention on Income and on Capital.

Party

124. The term “Party” means a State for which the Convention is in force pursuant to Article 48. For more detail about the application of the Convention to jurisdictions or territories for whose international relations a Party is responsible, see the explanatory text related to Article 42.

Period

125. The term “Period” is defined as the reporting period with respect to which an Ultimate Parent Entity prepares, or is required to prepare, Consolidated Financial Statements. A Period for purposes of the Convention will therefore follow financial accounting standards, which generally require an Ultimate Parent Entity to prepare consolidated financial statements annually for a period equal to twelve months (which means 365 days or 366 days in case of a leap year). Where an Ultimate Parent Entity prepares Consolidated Financial Statements for a reporting period that is longer or shorter than twelve months, it is generally required to disclose the reasons for this for accounting purposes. This is a rare event and is generally due to a change of the closing date for accounting, and in such an instance the Period for purposes of the Convention will continue to follow the length of the exceptional reporting period of the Consolidated Financial Statements.

126. As the Period is determined by reference to the reporting period of the Ultimate Parent Entity’s Consolidated Financial Statements, the adjustments required when applying the provisions set out in the Convention are kept to a minimum, compared with a situation where the Period would not follow the reporting period of the Consolidated Financial Statements. This increases certainty and clarity for businesses and tax administrations as the Convention applies on the basis of a Period that is consistent for a Group across all Jurisdictions (i.e. the Period is specific for the Group).

127. Some Jurisdictions may have to accommodate a situation where a Ultimate Parent Entity’s reporting period is not in line with the standard period on the basis of which an income tax liability is accrued under domestic law (e.g. the tax period in some Jurisdictions is fixed to start on 1 April and end on 31 March of each year while the Ultimate Parent Entity’s reporting period may start on 1 January or 1 July), for example by including a specific domestic law provision allowing the Group to reconcile the two different periods.

128. As is also clear from the definition of Consolidated Financial Statements, interim or intermediary statements or reports such as the ones prepared for disclosure or investor purposes do not determine a Period of a Group.

Return on Depreciation and Payroll

129. The term “Return on Depreciation and Payroll” has the meaning described in Annex B Section 5(1). See the explanatory text there for further details.

Signatory

130. The term “Signatory”, which is used exclusively in the final provisions of the Convention, refers to States that have signed the Convention pursuant to Article 41 but for which the Convention is not yet in force.

Specified Equity Interest

131. The term “Specified Equity Interest” refers to an equity interest that carries rights to the profits, capital or reserves of an Entity. This term refers only to ownership interests and does not include other rights to the profits, capital, or reserves of an Entity, such as profit-sharing agreements with employees that do not carry any equity rights to the Entity or creditors rights to compel sale of certain assets to satisfy an obligation of the Entity that is in default. An equity interest is an interest that is accounted for as equity under the financial accounting standard used in the preparation of the Consolidated Financial Statements. Similarly, whether a Group Entity is the owner of an equity interest, e.g. shares of stock that have been loaned to another person in connection with a short sale or stock sold with a repurchase obligation, is determined based on the accounting treatment of the interest in the Consolidated Financial Statements.

Taxable Presence

132. The term “Taxable Presence” refers to part of a Group Entity that is liable to tax on a net basis in a Jurisdiction other than the Jurisdiction in which the Group Entity is located for a Period. Taxable Presence specifically excludes *regulated financial institutions* defined in Annex C Section 2(3)(a) and *extractives entities* defined in Annex C Section 3(2)(c). This term also includes deemed Taxable Presences under Annex B Section 4(5)(e). This definition includes cases where tax is imposed on a net basis and the relevant deductions used to determine the net amount are based on estimated amounts or amounts that allow flexibility to the taxpayer or tax assessor to make estimations. In some cases, the part of the Group Entity that is liable to tax on a net basis in a Jurisdiction other than the Jurisdiction in which the Group Entity is located may be equivalent to the whole, a part, or a notional portion of the Group Entity.

133. Profits of a Group Entity may be subject to taxation in a Jurisdiction other than its location, for example where a Jurisdiction considers a permanent establishment to be present in its territory and taxes income attributable to that permanent establishment. In all instances where some or all of the Entity Financial Accounting Profit (or Loss) of a Group Entity are subject to taxation on a net income basis in a Jurisdiction other than the Jurisdiction where it is located, a separate Taxable Presence will be recognised in the former Jurisdiction. The Group Entity will then constitute the *main entity* under the definition of Annex B Section 4(13)(e). On this basis, it is possible for multiple *main entities* to have a Taxable Presence in one location and also possible for one *main entity* to have Taxable Presences in multiple locations.

134. The location of a Group Entity is determined under Annex B Section 4(5). Where more than one Jurisdiction considers the Group Entity a resident for tax purposes and imposes income tax on a net basis on that entity, paragraph 5 will deem one Jurisdiction to be the location of the Group Entity and under the definition of this subparagraph, a Taxable Presence will exist with respect to any Jurisdiction that considers the Group Entity a tax resident but is not selected under the tiebreaker rule in Annex B Section 4(5)(c). However, *taxable presence elimination profit (or loss)* will only be taken account in such a Jurisdiction under Annex B Section 4(3) to the extent that the Group Entity is actually liable to tax in that Jurisdiction. For instance, if a Jurisdiction does not impose any tax on a resident due to losing the residency tiebreaker included in the applicable tax treaty, the Taxable Presence that is considered to be located in this Jurisdiction will not give rise to any *taxable presence elimination profit (or loss)* for that Jurisdiction.

135. The definition of Taxable Presence includes traditional “fixed place of business” or “agency” permanent establishments. However, seeing as the definition aligns with taxing rights under a Jurisdiction’s

domestic law, it is not limited to traditional permanent establishment definitions or any considerations relating to physical presence. The definition covers all types of permanent establishments and significant economic presences, provided that tax is imposed on such presences on a net income basis, whether under an income tax or another similar type of tax. For the avoidance of any doubt, it includes instances where Diverted Profits Taxes are imposed on non-residents, irrespective of whether these taxes are treated as income taxes under domestic law. In addition, in cases where a Group Entity is resident in two Jurisdictions under the respective domestic law of the two Jurisdictions, the rules that relate to defining the location of a Group Entity or Taxable Presence (Annex B Section 4(5)) ensure that the Group Entity is located in only one such Jurisdiction and in cases where a tax based on net income is imposed in the other Jurisdiction, a Taxable Presence of the Group Entity will be deemed to exist in that other Jurisdiction.

136. The definition further includes instances where a Group Entity is subject to a change in *profit allocation amount* in a Jurisdiction, for example due to a *profit allocation adjustment* under Annex B Section 4(2)(c) and (7), after the Group Entity has changed its location from that Jurisdiction to another Jurisdiction. As such imposition of tax on the Group Entity by the Jurisdiction where the Entity is no longer located will give rise to a Taxable Presence in that Jurisdiction, and the *taxable presence elimination profit (or loss)* associated with the adjustment is recognised in the Jurisdiction where the tax is collected.

137. Annex B Section 4(2)(g) and (9)(b) ensure that where a Jurisdiction taxes a non-resident seller of an equity interest in a Group Entity on the difference between the tax basis and the consideration provided for the equity interest, this taxation will give rise to a Taxable Presence in that Jurisdiction of the Group Entity selling the equity interest.

138. Since the definition refers to net taxation, it does not apply to taxation levied on turnover, sales, consumption, imports or other non-income-based taxes. It similarly does not apply to taxes imposed on a gross basis, such as withholding taxes. Controlled Foreign Company (CFC) regimes that attribute income of an entity to resident shareholders using a deemed income approach will ordinarily not lead to a Taxable Presence, since the taxation is imposed on a resident entity rather than non-resident entities. Only where paragraph 5 would deem the location of the Group Entity subject to the CFC-regime to be in another Jurisdiction than the Jurisdiction imposing the tax, would a Taxable Presence arise.

139. The taxation of a *regulated financial institution*, as defined in Annex B Section 2(3)(a), or an *extractives entity*, as defined in Annex B Section 3(2)(c), will not give rise to a Taxable Presence under the definition of this subparagraph.

140. In any instance where a Group Entity is subject to a Qualified Domestic Minimum Top-Up Tax or similar taxation with respect to some or all of its profits in a jurisdiction other than the one where it is located as per Annex B Section 4(5) this will give rise a Taxable Presence being recognised in the location that the Qualified Domestic Minimum Top-Up Tax or similar tax is imposed.

Ultimate Parent Entity

141. The definition of an “Ultimate Parent Entity” is the starting point for identifying all the Group Entities that comprise the Group, and plays a key function in identifying a Covered Group, as defined in Article 3. The first part of the definition in subdivision (i) applies to identify an Ultimate Parent Entity if one of two conditions in subdivision (i) or (ii) are met.

Subdivision (i)

142. The Entity concerned must not be a *governmental entity* or a *pension fund*. In such cases an Entity (or Entities) at a lower level in the ownership chain will be an Ultimate Parent Entity for purposes of the Convention provided that Entity (or Entities) satisfies clauses (A) and (B). More than one Entity owned,

with a Controlling Interest, directly or indirectly by the same *governmental entity* or *pension fund* may qualify as an Ultimate Parent Entity for purposes of the Convention. In addition, the Entity must meet two conditions.

143. The first condition, contained in clause (A), requires that the Entity owns directly or indirectly a Controlling Interest in any other Entity. The definition of Controlling Interest is provided in Article 2 and uses a consolidation test (including a deemed consolidation test) to determine whether an Entity owns a Controlling Interest in another Entity. Therefore, the requirement in clause (A) will be met if: (i) an Entity has an equity interest that carries rights to profits, capital or reserves and is required to consolidate the assets, liabilities, income, expenses and cash flows of another Entity on a line-by-line basis in accordance with an Acceptable Financial Accounting Standard, or (ii) it would have been so required if the first-mentioned Entity had prepared consolidated financial statements in accordance with an Acceptable Financial Accounting Standard.

144. The second condition, contained in clause (B), states that the Entity must not be owned, with a Controlling Interest, directly or indirectly by another Entity, unless that Entity is a *governmental entity* or a *pension Fund*.

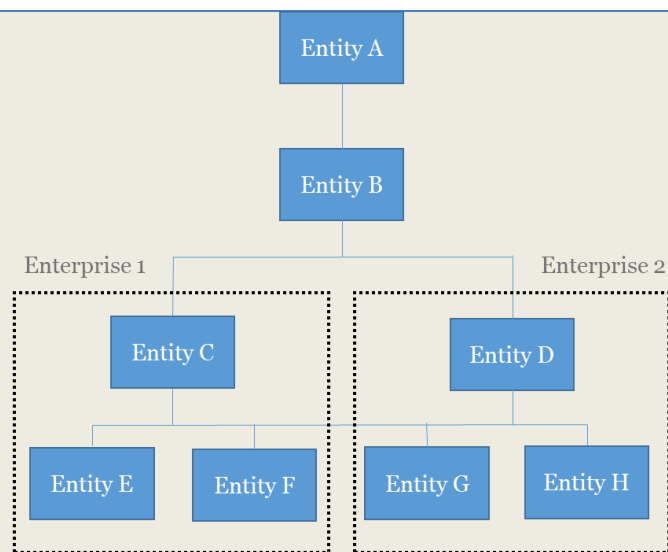
145. Therefore, it disqualifies an Entity from being the Ultimate Parent Entity of a Group if the Controlling Interest in that Entity is owned by another Entity (unless the latter Entity is a *governmental entity* or a *pension fund*). Stated differently, an Entity is not considered the Ultimate Parent Entity of a Group if there is another Entity higher in the ownership chain that owns directly or indirectly a Controlling Interest in any Entity, unless that other Entity is a *governmental entity* or a *pension fund* (in which case the first-mentioned Entity would satisfy the second condition). The phrase “unless that other Entity is a *governmental entity* or a *pension fund*” ensures that the next Entity in the chain of ownership could meet the condition in clause (B) even though its Controlling Interest is directly owned by a *governmental entity* or a *pension fund*, which are excluded from being an Ultimate Parent Entity.

146. An illustration of the application of the definition of an Ultimate Parent Entity where a *governmental entity* or a *pension fund* owns a Controlling Interest in other Entities can be found below.

Box 1. Example – Application of the definition of an Ultimate Parent Entity

Example 1

Two multinational enterprises are owned, with a Controlling Interest, directly or indirectly by Entity A, which is e.g. a *governmental entity*. In order to determine whether each enterprise is a Covered Group under Article 3, they must first identify an Ultimate Parent Entity for purposes of the Convention. Although Entity A satisfies clauses (A) and (B) of the definition of an Ultimate Parent Entity, it is not an Ultimate Parent Entity as it is a *governmental entity*.



It is therefore necessary to consider the application of the definition of an Ultimate Parent Entity to other Entities. This means that another Entity in the chain of ownership is an Ultimate Parent Entity for purposes of the Convention, provided that it: 1) owns directly or indirectly a Controlling Interest in any other Entity (clause (A) of the definition); 2) is not owned, with a Controlling Interest, directly or indirectly by another Entity, unless that Entity is a *governmental entity* or a *pension fund* (clause (B) of the definition); and 3) is not itself a *governmental entity* or a *pension fund*.

In this case, Entity B is an Ultimate Parent Entity pursuant to the definition. It owns directly or indirectly a Controlling Interest in other Entities, it is not owned, with a Controlling Interest, directly or indirectly by another Entity, that is not a *governmental entity* or a *pension fund* (Entity B is owned by Entity A which is a *governmental entity*) and is not itself a *governmental entity* or a *pension fund*. None of the Entities below Entity B is an Ultimate Parent Entity because those Entities are owned, with a Controlling Interest, directly or indirectly by Entity B (i.e. those Entities do not meet the conditions in clause (B) of the definition).

Example 2

In this second example, the facts are identical to Example 1 with the exception that Entity B is also a *governmental entity*. Therefore, both Entity A and Entity B cannot be considered an Ultimate Parent Entity for purposes of the Convention.

Pursuant to the definition of an Ultimate Parent Entity, both Entity C and Entity D are an Ultimate Parent Entity for purposes of the Convention as they: own directly or indirectly a Controlling Interest in other Entities; are not owned, with a Controlling Interest, by another Entity that is not a *governmental entity* or a *pension fund*; and they are themselves not a *governmental entity* or a *pension fund*.

Example 3 - Internal Fragmentation

The facts are the same as Example 2 with the following supplementary information:

- Entity B became a *governmental entity* (which is an Excluded Entity) following an arrangement that occurred after the date of public release of the final text of the Convention;

- Group C has Adjusted Revenues of EUR 11 billion in the Period and satisfies the profitability test in the Period;
- Group D has Adjusted Revenues of EUR 12 billion in the Period and satisfies the profitability test in the Period.

It is necessary to consider the *internal fragmentation* rule in Annex C Section 1(8) because: an arrangement occurred after the date of public release of the final text of the Convention to one or more of the Group Entities of the Group with Entity B as an Ultimate Parent Entity; and Groups C and D are owned, with a Controlling Interest, directly by an Excluded Entity (Entity B) and each have Adjusted Revenues lower than EUR 20 billion in the Period (i.e. the two pre-conditions of the rule are met). The anti-fragmentation rule requires the Adjusted Revenues of Group C and Group D to be aggregated to assess whether the combined Adjusted Revenues are greater than the EUR 20 billion monetary threshold in Article 3(1)(a) because:

- Groups C and D each satisfy the profitability test;
- Groups C and D each result from the same *internal fragmentation* and each of their Ultimate Parent Entity is owned, with a Controlling Interest, directly or indirectly by an Excluded Entity.

In this case, the aggregated Adjusted Revenues meet the revenue test (EUR 11 billion + EUR 12 billion > EUR 20 billion) and therefore, provided that it is reasonable to conclude, having regard to all relevant facts and circumstances, that failing the revenue test in Article 3(1)(a) was one of the principal purposes of the *internal fragmentation* that resulted in Group C and Group D, both Group C and Group D are deemed to have met the test independently.

Assuming the principal purpose test is met, both Groups C and D will be in scope of the Convention for the Period. Although the Adjusted Revenues are aggregated for the purpose of applying the revenue test in Article 3(1)(a), once the conditions in Annex C Section 1(8)(a) and (b) are met then each Group applies the rest of the Convention separately.

Subdivision (ii)

147. Subdivision (ii) expands the definition to include a single Entity, provided that Entity does not satisfy the specified conditions found in clauses (A) through (D), and is not an Entity described in subdivision (i).

148. The conditions in clauses (A) through (D) are that the Entity is not part of another Group, is not an Excluded Entity, not an *investment fund* and not a *real estate investment vehicle*.

UN Model

149. The term “UN Model” means the United Nations Model Double Taxation Convention Between Developing and Developed Countries.

Withholding tax upward adjustment

150. This definition refers to the meaning assigned to it in Annex B Section 6(1). Relevant explanatory statement text can be found in paragraph 1545 onwards.

Article 3 – Covered Group

151. Article 3 contains the rules to determine whether a Group is a “Covered Group” and therefore within the scope of the Convention.

Paragraph 1

152. Paragraph 1 provides that a Group is a Covered Group, subject to paragraph 2, for a Period if that Group has both Adjusted Revenues greater than EUR 20 billion and a *pre-tax profit margin* that is greater than 10 per cent in that Period.

Revenue test

153. The revenue test in Article 3(1)(a) is a comparison of the Adjusted Revenues of a Group in a Period and an absolute monetary threshold of EUR 20 billion. Unlike the test in Article 3(2)(b), there is no requirement to test the average Adjusted Revenues of a Group across more than one Period.

154. The definition of Adjusted Revenues is provided in Article 2 and provides that Adjusted Revenues means the revenues reported in the Consolidated Financial Statement of the Group, subject to prescribed adjustments. This means that, under paragraph 1(a), the revenue test is applied at the level of revenues reported in the Consolidated Financial Statements, subject to prescribed adjustments, prior to applying the exclusions for Extractive Activities, Regulated Financial Services, autonomous domestic businesses and Defence under Article 3 and their associated Sections in Annex C.

155. Where the Adjusted Revenues of a Group are greater than EUR 20 billion, the revenue test is met. Where a Group has Adjusted Revenues equal to or less than this monetary threshold for a Period, it is not a Covered Group for that Period and there will be no need for a taxpayer to consider whether the test in subparagraph (b) is satisfied (unless the conditions in Annex C Section 1(7) are met).

156. The term “Period” is defined in Article 2 as the reporting period with respect to which the UPE of the Group prepares Consolidated Financial Statements. Where the Period is shorter or longer than twelve months, which means 365 days or 366 days in case of a leap year, paragraph 10 provides that the monetary threshold of EUR 20 billion is adjusted proportionally to correspond with the length of the Period.

Profitability test

157. The profitability test in Article 3(1)(b) provides a rule which measures a Group’s profitability by reference to its *pre-tax profit margin*. The profitability test in this subparagraph is satisfied for a Period if a Group earns a *pre-tax profit margin* that is greater than 10 per cent in the Period. If that test is not satisfied, a Group will not be a Covered Group even if it satisfies the revenue test in Article 3(1)(a). The definition of *pre-tax profit margin* is provided in paragraph 3.

Paragraph 2

158. Paragraph 2 applies in addition to the requirements of paragraph 1. This means that a Group that meets the conditions set out in paragraph 1 for a Period, and meets the requirement in the chapeau of paragraph 2, will not be a Covered Group unless it also meets the conditions in paragraph 2. Paragraph 2 applies if a Group has never been a Covered Group, or has not been a Covered Group for the two Periods immediately preceding the Period (or if a Group was in existence for only one Period preceding the Period, has not been a Covered Group for that one Period). A Group can only be a Covered Group for a Period

for which the Convention has entered into effect. A Group must meet two additional tests to be a Covered Group (subject to the tail end clause in paragraph 2 which turns off one of those two tests in a specific situation).

159. The profitability test is satisfied for a Period if a Group that has never been in scope or has been out of scope for the two Periods immediately preceding the Period (or if a Group was in existence for only one Period preceding the Period, has been out of scope for that one Period) meets the conditions in paragraph 1 and both of the following conditions (or only subparagraph (b) per the tail end clause):

- Subparagraph (a) requires that a Group must earn a *pre-tax profit margin* that is greater than 10 per cent in at least two of the four Periods that immediately preceded the Period. For each Period covered under this test, the *pre-tax profit margin* must be determined in accordance with paragraph 3.
- Subparagraph (b) provides that a Group must earn a *pre-tax profit margin* that is greater than 10 per cent on average for the Period and the four (or shorter term, see paragraph 162) Periods that immediately precede the Period.

160. The calculation in subparagraph (b) produces an average *pre-tax profit margin*, that is weighted according to the Adjusted Revenues of the Group for the same Period. Using a weighted average provides an economically valid measure of the *pre-tax profit margin* across the Period and the four immediately preceding Periods.

161. Where a negative *pre-tax profit margin* arose in one or more of the four Periods that immediately preceded the Period, this will be taken into account in the numerator given that the Adjusted Profit Before Tax will be negative (see the example below). A consequence is that any Financial Accounting Loss incurred in a Period (that produces a negative *pre-tax profit margin* in that Period, taking into account the relevant adjustments) will not also be offset against Financial Accounting Profits generated by the Group in subsequent Periods for purposes of the calculation in subparagraph (b). This is consistent with the definition of *pre-tax profit margin* provided in paragraph 3 and prevents any duplication or double-counting of the relevant Financial Accounting Loss (i.e. one time for the purpose of calculating the *pre-tax profit margin* of the Period where it arose, and another time if carried-forward to reduce the *pre-tax profit margin* of a later Period).

162. The tail end clause in paragraph 2 provides that where a Group was established relatively recently and, as a result, relevant financial data (e.g. *pre-tax profit margin*, Adjusted Profit Before Tax, and Adjusted Revenues) is available for fewer than all of the four Periods that immediately precede the Period because the Group did not exist during one or more of those Periods (for example, all the Group Entities were established after the fourth Period that immediately precedes the Period), and the relevant financial data is not identified under Annex C Section 1(1), the *pre-tax profit margin* for purposes of the average test in subparagraph (b) is calculated by taking into account that Period and the Periods during which a Group existed that immediately precede the Period. In contrast, the prior period test in subparagraph (a) requires at least four prior Periods in order to apply. One or more transactions involving Group Entities that occur during a Period and are transactions regarded as taking place under common control for purposes of an Acceptable Financial Accounting Standard (which may include transactions involving the insertion of a new Ultimate Parent Entity), will not have an impact on whether a Group is considered to exist during a preceding Period.

163. Where a Group was a Covered Group in at least one of the two Periods immediately preceding the Period (or if a Group was in existence for only one Period preceding the Period, it was in scope in that one Period), paragraph 2 does not apply in addition to paragraph 1. In such circumstances, the profitability

test consists only of paragraph 1(b). If a Group was not a Covered Group in both (i.e. each) of the two Periods immediately preceding the Period, then the profitability test includes not only the test in paragraph 1(b) but also the two tests in paragraph 2. For example, a Group that has not previously been a Covered Group would be a Covered Group for Period 1 if it satisfied the conditions in paragraphs 1 and 2 for that Period. In Period 2, only paragraph 1 would be relevant (and for purposes of profitability, that means paragraph 1(b) only) if the Group was a Covered Group in Period 1. Paragraph 2 would not apply. If the Group has a level of profitability below the threshold in Period 2, it will not be a Covered Group for that Period. If that lower level of profitability in Period 2 was exceptional and the Group satisfies the conditions in paragraph 1 for Period 3, it will be a Covered Group. Alternatively, if the Group also fails the conditions in paragraph 1(b) in Period 3, then paragraph 2 will become relevant in determining whether the Group is a Covered Group in Period 4.

Box 2. Example – Article 3(2)

Example 1

For purposes of this example, assume that Group A has published Consolidated Financial Statements for more than ten Periods. Group A has not been a Covered Group in any prior Period and meets the conditions in Article 3(1) for the Period. Therefore, it should be assessed whether the Group has access to Article 3(2)(a) and (b) to determine whether the Group is a Covered Group for the Period.

Given that Group A has not been a Covered Group before, it meets the requirement in the chapeau of Article 3(2) and therefore the tests in subparagraphs (a) and (b) apply. In this case, both the tests in Article 3(2)(a) and (b) apply because Group A has published Consolidated Financial Statements for more than four Periods immediately preceding the Period.

Assume Group A satisfies the conditions in Article 3(2)(a), the remaining test to determine whether Group A is a Covered Group for the Period is the test in Article 3(2)(b). The table below provides the relevant financial results of Group A, as adjusted under the Convention, for purposes of the calculation in Article 3(2)(b).

	Adjusted Revenues (EUR'000,000)	Adjusted Profit Before Tax (calculated pursuant to Annex B Section 2(1) as though the Group were a Covered Group and without taking into account <i>relevant net</i> <i>losses</i>) (EUR'000,000)
The Period	29,000	5,220
P-1	25,000	5,000
P-2	22,000	3,080
P-3	16,500	(1,155)
P-4	17,000	2,720

In order to determine whether the *pre-tax profit margin* of Group A meets the test in Article 3(2)(b), the calculation is as follows:

$$\frac{(5,220 + 5,000 + 3,080 + -1,115 + 2,720)}{(29,000 + 25,000 + 22,000 + 16,500 + 17,000)}$$

Expressed as a percentage = 13.58%. As 13.58% > 10%, Group A meets the test in Article 3(2)(b).

Example 2

Assume that Group B has published Consolidated Financial Statements for more than ten Periods. Group B was a Covered Group in one of the two Periods that immediately precede the Period and meets the conditions in Article 3(1) for the Period.

The tests in Article 3(2)(a) and (b) do not apply because Group B does not meet the requirement in the chapeau of Article 3(2), as a result of being a Covered Group in one of the two Periods that immediately precede the Period, and, as a result Group B will be a Covered Group for the Period.

Example 3

Assume all of that the Group Entities of Group C were established within the past four Periods. As a result, Group C has published Consolidated Financial Statements for four Periods in total: the Period and three prior Periods. Group C has not been a Covered Group in any prior Period and meets the conditions in Article 3(1) for the Period.

Given that Group C has not been a Covered Group before, it meets the requirement in the chapeau of Article 3(2) and therefore the tests in subparagraphs (a) and (b) are applicable. However, in this case, Article 3(2)(a) is switched off by the tail end clause in paragraph 2 and only the test in Article 3(2)(b) applies (as modified by the tail end clause) because Group C has published Consolidated Financial Statements for fewer than five Periods and no relevant financial data (i.e. *pre-tax profit margin*, Adjusted Profit Before Tax, and Adjusted Revenues) is available for all of the four Periods that immediately precede the Period as all of the Group Entities were newly established.

The table below provides the relevant financial results of Group C, as adjusted under the Convention, for purposes of the calculation in Article 3(2)(b), as modified by the tail end clause, to take into account the Periods for which Consolidated Financial Statements are available.

	Adjusted Revenues (EUR'000,000)	Adjusted Profit Before Tax (calculated pursuant to Annex B Section 2(1) as though the Group were a Covered Group and without taking into account <i>relevant net losses</i>) (EUR'000,000)
The Period	22,000	6,500
P-1	18,000	5,300
P-2	10,000	(3,500)
P-3	3,000	(5,000)

In order to determine whether the *pre-tax profit margin* of Group C meets the test in Article 3(2)(b), Group C must perform the following calculation:

$$\frac{(6,500 + 5,300 + -3,500 + -5,000)}{(22,000 + 18,000 + 10,000 + 3,000)}$$

Expressed as a percentage = 6.23%. As 6.23% ≤ 10%, Group C does not meet the test in Article 3(2)(b).

Paragraph 3

164. Paragraph 3 defines “pre-tax profit margin”. It is a test of profitability expressed as a percentage of the Adjusted Revenues of the Group in a given Period. This test considers the Adjusted Profit Before Tax of a Group for a Period calculated pursuant to Annex B Section 2(1) as though the Group were a Covered Group for each period separately and does not take into account losses which may have accrued in earlier Periods. A *pre-tax profit margin* may be positive or negative, depending on the Financial Accounting Profit (or Loss) of the Group, after making the relevant tax base adjustments.

165. The calculation of *pre-tax profit margin* for purposes of paragraph 2 is generally not impacted by an arrangement or transaction that is reported as a business combination in the Consolidated Financial Statements of the Group (e.g. transactions with unrelated parties to acquire the whole or part of an existing business). This is because the business combination will already be reflected in the Consolidated Financial Statements of the Group in the Period of the business combination, and there is no additional requirement to retrospectively restate the Consolidated Financial Statements of the Group in prior Periods in accordance with this business combination (and hypothesise a Group that did not exist in those prior Periods).

166. For example, assume that in the tested Period a Group acquires an interest in a business that meets the definition of an “Entity”. If the acquired Entity meets the definition of a “Group Entity”, it will become a member of the Group in the Period of the acquisition where the Ultimate Parent Entity includes its assets, liabilities, income, expenses and cash flows in its Consolidated Financial Statements for the Period. Therefore, in the Period of the acquisition the financial results of the acquired Entity or Entities will be reflected in the Consolidated Financial Statements of the Ultimate Parent Entity. In contrast, the Consolidated Financial Statements of the Ultimate Parent Entity in the four immediately preceding Periods will not include the financial results of the acquired Entity (or Entities), and there is no requirement for purposes of the prior period test and the average test to retrospectively prepare the Consolidated Financial Statements of the Ultimate Parent Entity in the four Periods immediately preceding the Period, on the hypothetical basis that the Entity (or Entities) acquired in the tested Period were part of the Group in those preceding Periods. In case of a *group merger* or a *group demerger* however, a different approach is taken (see paragraph Annex C Section 1(1)).

Paragraph 4

167. Paragraph 4 provides that the application of the Convention to a Group that includes a *regulated financial institution* is determined by reference to Annex C Section 2. The result is that the provisions of Article 3 apply to a Group by excluding the *regulated financial institutions* of a Group.

168. Annex C Section 2 sets out the definitions required to perform those adjustments.

Paragraph 5

169. Paragraph 5 provides that the application of the Convention to a *qualifying extractives group* is determined by reference to Annex C Section 3. The result is that the provisions of Article 3 apply to a Group by excluding the profits of the Group that relate to extractives.

170. Annex C Section 3 sets out the definitions required to perform those adjustments.

Paragraph 6

171. Paragraph 6 provides that the application of the Convention to a *disclosed segment* of a Group is determined by reference to Annex C Section 4.

172. Paragraph 6 applies to all Groups that report a *disclosed segment*, but most of the Convention – including the operative provisions, as modified by Section 4 – apply only to a *segment entity* of a *covered segment*. Broadly, this means that the scope rules contained in Annex C Section 4(1) and (2) and supporting definitions will apply to all enterprises meeting the definition of a *disclosed segment* (whether that *disclosed segment* is a *covered segment* or not), and that the other rules contained in the Convention will apply, as modified by Annex C Section 4, only to *segment entities* of a *covered segment*.

173. The definitions of *disclosed segment* and *segment entity* are provided in Annex C Section 4(8) and (9). *Disclosed segment* means any segment reported in a Group's Consolidated Financial Statements. Importantly, this means *disclosed segments* reported on a business line, geographic or any other basis can qualify as a *covered segment* for purposes of the Convention (for more detail, see paragraph 2048 of the Explanatory Statement).

174. Section 4 contains the rules that govern the application of the obligations contained in the Convention to any *segment entity* of a *covered segment* for a Period. Section 4 also contains definitions that are specific to segmentation.

175. For the purpose of applying the Convention, two or more *disclosed segments* of a Group are treated as if those segments are independent. This effectively means that such *disclosed segments* are treated as standalone businesses and the financial results of the *disclosed segments* of a Group are not combined for the purpose of applying the Convention.

Paragraph 7

176. Paragraph 7 provides that Annex C Section 5(6) and (7) on the autonomous domestic business exemption apply, which contain supplementary provisions in the form of a de minimis rule for determining whether a Group, that is otherwise a Covered Group under Article 3, is a Covered Group in cases where that Group operates in one or more *autonomous domestic business jurisdictions*.

177. Section 5 also contains the adjustments, in paragraphs 3 through 5 and 11 through 12, that shall be made in a Period if a Covered Group operates in a Party that is an *autonomous domestic business jurisdiction* (for more detail, see paragraph 2086 of the Explanatory Statement). The definition of *autonomous domestic business jurisdiction* is provided in Annex C Section 5(2)(a).

178. As noted above, Article 3(4) makes provision for an exclusion in respect of a Group including one or more *regulated financial institutions*, Article 3(5) makes provision for an exclusion in respect of a *qualifying extractives group* and Article 3(8) makes an adjustment in respect of a *defence group*. In the case of a Group for which one or more of those provisions is relevant, and for which the autonomous domestic business exemption is also relevant, all of the provisions in Article 3(4), (5), (7), and (8) apply. Such a Group would have flexibility as to whether it applies the exclusions first (in any order), or the autonomous domestic business exemption first, provided that in any event the defence adjustment is applied before the autonomous domestic business exemption. However, if the Group is not in scope of the Convention after the application of only one or more of those exclusions, it would not need to apply the other exclusion(s) or the autonomous domestic business exemption. If the Group is in scope of the Convention after the application of one (or subsequent) exclusions, then those exclusions would be applied cumulatively and based on adjusted amounts. For example, if a Group chose to apply the exclusion relevant to a *qualifying extractives group* first, it would subsequently apply the exclusion relevant to a Group including one or more *regulated financial institutions* using the *non-extractives adjusted revenues* and not the Adjusted Revenues of the Group.

Box 3. Example – Application of Article 3(4) through (8)

Example 1

A multinational enterprise, Group A, meets the revenue and profitability tests in Article 3(1) and (2) for the first time in Period 2030 and was thus not a Covered Group in any prior Period. Group A conducts *extractives activities* and includes *regulated financial institutions*. The Group does not report any *disclosed segments* and does not earn *defence revenues*.

To determine whether Group A is a Covered Group for 2030, the Group chooses to first apply the exclusion for extractive activities in Article 3(5) as the Group is a *qualifying extractives group*. It re-tests the conditions in Article 3(1) and (2) by taking into account its *non-extractives adjusted revenues* and *non-extractives adjusted profit before tax*. Following this re-test, Group A still meets the tests in Article 3(1) and (2).

Subsequently, the Group applies the exclusion for *regulated financial institutions* in Article 3(4) and it re-tests the conditions in Article 3(1) and (2). It applies the exclusion for *regulated financial institutions* cumulatively by taking into account its *non-extractives adjusted revenues* and *non-RFS adjusted revenues* as well as its *non-extractives adjusted profit before tax* and *non-RFS adjusted profit before tax*. Following this second re-test, Group A fails the tests in Article 3(1). This means that Group A will not be a Covered Group for 2030.

Example 2

A multinational enterprise, Group B, meets the revenue and profitability tests in Article 3(1) and (2) for the first time in Period 2030 and was thus not a Covered Group in any prior Period. Group B reports two *disclosed segments* in its Consolidated Financial Statements neither of which were a *covered segment* in any prior Period: *disclosed segment A* which conducts *extractives activities* and *disclosed segment B* which conducts other activities. *Disclosed segment B* does not include a *regulated financial institution* and does not earn *defence revenues*.

To determine whether Group B is a Covered Group for 2030, the Group chooses to first apply the exclusion for extractive activities in Article 3(5) as the Group is a *qualifying extractives group*. It re-tests the conditions in Article 3(1) and (2) by taking into account its *non-extractives adjusted revenues* and *non-extractives adjusted profit before tax*. Following this re-test, Group A fails the profitability tests in Article 3(1) and (2). This means that Group A will not be a Covered Group for 2030.

Next, the Group has to assess whether its *disclosed segment B* meets the revenue and profitability tests in Article 3(1) and (2) to determine whether that *disclosed segment* is a *covered segment* for 2030 because the Group's *non-extractives adjusted revenues* meet the requirements of Article 3(1)(a) (see Annex C Section 4(1)(a)). Assuming that *disclosed segment B* meets the requirements of Article 3(1) and (2) (as modified by Annex C Section 4) for 2030, it will be a *covered segment* for that Period.

However, *disclosed segment B* will, to the extent relevant, be able to apply the autonomous domestic business exemption adjustments provided for in Annex C Section 5. That may mean that following the application of Annex C Section 5(6) or (7) *disclosed segment B* is not a *covered segment*.

Example 3

A multinational enterprise, Group C, meets the revenue and profitability tests in Article 3(1) and (2) for the first time in Period 2030 and was thus not a Covered Group in any prior Period. Group C earns *defence revenues* does not report any *disclosed segments* and operates autonomously in several Jurisdictions.

To determine whether Group C is a Covered Group for 2030, the Group must make the defence adjustments provided for in Annex C Section 6 prior to applying the autonomous domestic business exemption adjustments provided for in Annex C Section 5. The Group will not re-test the conditions in Article 3(1) and (2) after performing the defence adjustment but it may no longer be a Covered Group if Annex C Section 6(4) applies. Assuming that is not the case, and the Group is a Covered Group after the defence adjustments, the Group will then be able to apply the autonomous domestic business exemption adjustments.

Example 4

A multinational enterprise, Group D, meets the revenue and profitability tests in Article 3(1) and (2) for the first time in Period 2030 and was thus not a Covered Group in any prior Period. Group D includes *regulated financial institutions*, does not report any *disclosed segment* and operates autonomously in several Jurisdictions.

To determine whether Group D is a Covered Group for 2030, the Group makes the autonomous domestic business exemption adjustments provided for in Annex C Section 5 and it determines that it satisfies the requirements in Annex C Section 5(7). This means that the Group will not be a Covered Group for 2030.

Example 5

A multinational enterprise, Group E, meets the revenue and profitability tests in Article 3(1) and (2) for the first time in Period 2030 and was thus not a Covered Group in any prior Period. Group E conducts *extractives activities*, does not report any *disclosed segment* and operates autonomously in several Jurisdictions.

To determine whether Group E is a Covered Group for 2030, the Group chooses to first apply the exclusion for extractive activities in Article 3(5) as the Group is a *qualifying extractives group*. It re-tests the conditions in Article 3(1) and (2) by taking into account its *non-extractives adjusted revenues* and *non-extractives adjusted profit before tax*. Following this re-test, Group E meets the tests in Article 3(1) and (2). This means that Group A will be a Covered Group for 2030.

However, the Group will, to the extent relevant, be able to apply the autonomous domestic business exemption adjustments provided for in Annex C Section 5 which may mean that, following the application of Annex C Section 5(6) or (7), it is not a Covered Group. Annex C Section 5 will apply to the Group's *non-extractives adjusted revenues* and *non-extractives adjusted profit before tax*.

Paragraph 8

179. Paragraph 8 provides that for the purpose of applying the Convention to a Group that is a *defence group* and is otherwise a Covered Group, Annex C Section 6(4) applies. The result is that the provisions of Article 3 apply to a Group by excluding the profits (or losses) of the Group that relate to defence.

180. Annex C Section 6(4) sets out the definitions required to perform those adjustments.

Paragraph 9

181. Paragraph 9 provides for the lowering of the Adjusted Revenues threshold, from EUR 20 billion to EUR 10 million pursuant to the application of Article 43(1). See the Explanatory Statement relating to that provision for further detail.

Paragraph 10

182. Paragraph 10 provides for a proportionate adjustment to monetary thresholds within the Convention that apply by reference to a Period in circumstances where the Period for a Covered Group is shorter or longer than twelve months. This recognises that Groups may in certain circumstances shorten or lengthen a reporting period in line with an Acceptable Financial Accounting Standard.

183. The adjustment is not required if the Ultimate Parent Entity of a Group prepares Consolidated Financial Statements for a reporting period that is a leap year (which contains more than 365 days) because in such case the Consolidated Financial Statements will cover a twelve-month Period. For Periods that are shorter or longer than twelve months, any proportionate adjustment should be done by reference to the number of days in that Period to a reference period of, for simplicity, 365 days.

184. The adjustment required by paragraph 10 only applies to monetary amounts contained within the Convention that are determined by reference to a Period, such as the thresholds in Articles 3(1)(a), 5(1)(b), 8, and 10(b) and (c), and in Annex C Sections 1(7) and 5(7)(b)(ii)(A) and (B). It does not require any adjustment to absolute monetary amounts that are not calculated by reference to a Period.

Box 4. Example – Period longer or shorter than 12 months

Period longer than 12 months

The reporting period for which the UPE of Group A ordinarily prepares Consolidated Financial Statements starts on 1 July and ends on 30 June of each calendar year.

In September 2022 Group A decides, consistent with the relevant Acceptable Financial Accounting Standard, to start its reporting period on 1 January as from 2024. Therefore, Group A prepares Consolidated Financial Statements for a 549 day reporting period from 1 July 2022 to 31 December 2023 in order to implement the transition. Group A reports Adjusted Revenues of EUR 28 billion for the Period 1 July 2022 - 31 December 2023.

Pursuant to paragraph 10, any monetary amounts in the Convention that are determined by reference to a Period are adjusted proportionally. Using the revenue threshold as an illustration, the revenue threshold in this example would be adjusted as follows:

$$20 \text{ billion} \times \frac{549}{365} = 30 \text{ billion}$$

The revenue test is not met for Group A's Period 1 July 2022 - 31 December 2023 as its Adjusted Revenues of EUR 28 billion are not greater than the adjusted revenue threshold of EUR 30 billion. Absent any adjustment to the revenue threshold, Group A would inadvertently meet the revenue test for that Period.

Period shorter than 12 months

Instead of closing its ongoing reporting period on 30 June 2023, Group A decides to close it on 31 December 2022. Therefore, Group A prepares Consolidated Financial Statements for a 184 day reporting period from 1 July 2022 – 31 December 2022 in order to implement the transition, consistent with the relevant Acceptable Financial Accounting Standard. Group A reports Adjusted Revenues of EUR 11 billion for the Period 1 July 2022 - 31 December 2022.

The revenue threshold for that Period is adjusted proportionally as follows:

$$20 \text{ billion} \times \frac{184}{365} = 10 \text{ billion}$$

Group A meets the revenue test for its Period 1 July 2022 - 31 December 2022. Absent any adjustment to the revenue threshold, Group A would inadvertently not meet the revenue test for that Period.

Part III – Allocation and taxation of profits

Article 4 – Taxation of Profits of a Covered Group

185. Article 4 sets out the circumstances under which a Party that is a market jurisdiction may impose tax on the Designated Payment Entity of a Covered Group with respect to the portion of the Amount A Profit of the Covered Group that is allocated under Article 5 to that Party for a Period.

186. Under Article 4, the entirety of a Covered Group's liability for amounts covered by the Convention falls on the Designated Payment Entity, while relief for double taxation on such amounts by *relieving jurisdictions* (determined by Article 11) is required to be provided to each *relief entity* identified under Article 13. This approach reduces the administrative compliance burden for Covered Groups and tax administrations by reducing the number of entities that are liable to tax under the Convention, while still ensuring double taxation is eliminated at the level of the Group.

187. At the same time, the compensation payment provisions in Article 13(6) through (11) to the Convention are intended to ensure that the entities identified in accordance with Article 13 compensate the Designated Payment Entity of a Covered Group for the tax burden induced by Amount A.

188. This Article also deals with the case where Jurisdictions that would be required to eliminate double taxation under Article 11 are not Parties to the Convention. It provides in some cases for a reduction of the Amount A Profit of the Covered Group that is allocated to a Party for a Period under Article 5. This reduction is intended to reflect the share of Amount A Profit corresponding to the non-participating *relieving jurisdiction*, on which this Jurisdiction is not surrendering its taxing rights, and which is hence subtracted from the Amount A Profit allocated to the market jurisdiction.

189. Article 4 does not require nor specify how a Party is required to exercise the taxing right afforded under the Convention. A Party is free to self-determine whether Amount A Profit subject to Article 4 is taxed under the Party's already established income tax regime, or taxed separately, independent of its current income tax regime. However, the choice to integrate the taxation of Amount A Profit into an existing income tax regime of a Party or to tax Amount A Profit separately may have implications in relation to other Articles in the Convention (including for streamlined compliance, see Article 16).

Paragraph 1

190. Under paragraph 1, a Party may impose tax on the Designated Payment Entity of a Covered Group if that Party has nexus under Article 8. Nexus under Article 8 is established if the Covered Group has Adjusted Revenues in a Party equal to or greater than EUR 1 million (or in the case of a Party with a gross domestic product of less than EUR 40 billion with respect to the Period, EUR 250 000).

Paragraphs 2 and 3

191. Paragraph 2 adjusts the amount of Amount A Profit that may be taxed in a Party for a period in accordance with paragraph 1. The effect of the adjustment in paragraph 2 is to reduce the amount subject to tax in a market jurisdiction proportionally by the amount of relief obligation that has been allocated under Article 11 to certain Jurisdictions that are not Parties to the Convention.

192. The reduction is intended to have the effect that a Party should be able to impose the same amount of taxation on the Designated Payment Entity as it would have in aggregate if *relief entities* bore the legal liability for amounts under the Convention.

193. Paragraph 2 provides that such Amount A Profit shall be reduced by the product of two factors.

194. The first factor, in paragraph 2(a), is the portion of the Amount A Profit of a Covered Group that is allocated under Article 5 to that Party for a Period. That is, the amount of Amount A Profit the Party may impose tax on if no reduction under paragraph 2 was applicable.

195. The second factor is the ratio of the *Amount A relief amount*, excluding any *prior unallocated Amount A relief*, allocated to non-participating Parties to the Convention to the *Amount A relief amount* of the Covered Group, excluding any *prior unallocated Amount A relief*.

196. Paragraph 2(b)(i) contains the numerator which is the sum of the *Amount A relief amount*, excluding any *prior unallocated Amount A relief*, with respect to which the obligation to provide relief from double taxation is allocated to any *relieving jurisdiction* under Article 11, which is not a Party to the Convention, and which has an agreement for the avoidance of double taxation with the Party that is allocated Amount A Profit.

197. However, paragraph 3 provides that until two years after the Convention has entered into force, the amount for the numerator in paragraph 2(b)(i) will include all *Amount A relief amount* allocated to *relieving jurisdictions* that are not Parties to the Convention, irrespective of whether they have a double tax treaty with the Party that is allocated Amount A Profit.

198. Paragraph 2(b)(ii) contains the denominator, which is the Covered Group's *Amount A relief amount*, excluding any *prior unallocated Amount A relief*, allocated to *relieving jurisdictions* (whether or not they are Parties) in accordance with Article 11.

199. The effect of the two elements can be reflected formulaically below:

Amount A profit allocated to the Party under Article 5

×

Amount A relief amount (excluding any prior unallocated Amount A relief) allocated to any Non – Participating Jurisdictions
Amount A relief amount of the Covered Group (excluding any prior unallocated Amount A relief)

200. Both subdivisions (i) and (ii) refer to the “Amount A relief amount”. Article 11(3) then determines the amount each *relieving jurisdiction* is allocated of the “Amount A relief amount” of the Covered Group. However, the “Amount A relief amount” is the “Amount A Profit” increased in circumstances where there is an amount of “prior unallocated Amount A relief” of a Covered Group.

201. Therefore, for the purpose of determining any adjustments under paragraph 2, any amounts attributable to *prior unallocated Amount A relief* should not be included in the numerator or the denominator of the fraction in paragraph 2(b). For subdivision (ii) the amount not to be included in the denominator would be the entire amount of any *prior unallocated Amount A relief* of the Covered Group. Whereas, for the numerator in subdivision (i), this would be the proportion of Group's *prior unallocated Amount A relief* allocated to each *relieving jurisdiction* that met the requirements of subdivision (i) in relation to the Party. The proportion of the Group's *prior unallocated Amount A relief* allocated to each *relieving jurisdiction* is the same proportion as the *Amount A relief amount* allocated to each *relieving jurisdiction*.

202. This ensures that any reduction of the Amount A Profit to a Party under paragraph 2 only takes into account the Amount A Profit for that Period and removes any *prior unallocated Amount A relief* from the adjustment. A corresponding adjustment for the purposes of double taxation relief under Article 12 is outlined in the Explanatory Statement to Article 12.

203. Paragraph 2(b)(i)(B) will be met if at any time during the relevant Period, the Party and the relevant Jurisdiction have an agreement in effect that contains a provision corresponding to Article 7 (Business profits) of the OECD Model or Article 7 (Business profits) of the UN Model. The term “corresponding to” should be taken to be similar or equivalent in effect as the aforementioned business profits articles, rather than requiring the relevant article to reflect the exact wording. If a future agreement between the Party and the relevant jurisdiction explicitly acknowledges the right of the Party to impose taxation on profits allocated to it under the MLC, it would not correspond to Article 7 of the abovementioned models and would thus be disregarded for purposes of this paragraph.

Article 5 – Allocation of Profit associated with revenues in Market

204. Article 5 specifies the Amount A Profit of a Covered Group that is allocated to a Jurisdiction for a Period. The Amount A Profit is the profit of the Covered Group on which a Party may impose tax on the Designated Payment Entity under Article 4 (Taxation of Profits of a Covered Group) in a Period and is also relevant for purposes of determining the *Amount A relief amount* on which relief is provided under Part IV (Elimination of Double Taxation).

Paragraph 1

205. Paragraph 1 contains a two-step process to determine the portion of the Amount A Profit of a Covered Group that is allocated to a Jurisdiction for a Period. These steps are applied on a jurisdictional basis. Amount A Profit is only allocated to Jurisdictions in which a Covered Group has nexus under Article 8 for a Period.

206. The first step (contained in subparagraph (a)) is to allocate the Amount A Profit at a Group level (as defined in Article 2(d)) to specific market jurisdictions that satisfy the nexus threshold (refer to Article 8). To determine the allocation to a given Jurisdiction, the Amount A Profit of the Covered Group for the Period is multiplied by the Adjusted Revenues of the Covered Group for the Period that are sourced to that Jurisdiction under Article 6 and divided by the total Adjusted Revenues of the Covered Group for the Period (see Article 2) to determine the Amount A Profit allocated to that Jurisdiction prior to any *marketing and distribution profits safe harbour adjustment* at paragraph 1(b). Where a market jurisdiction does not receive allocations that it would otherwise be entitled to on the basis that the applicable nexus threshold (see Article 8) is not satisfied in that Jurisdiction or because it is not a Party to the Convention for the Period, this does not have any effect on the amounts that are allocated to other Jurisdictions.

Box 5. Example – Steps to calculate Amount A Profit under Articles 2(d) and 5(1)

For purposes of this example, Covered Group A has Adjusted Revenues of EUR 100 billion and *adjusted profit before tax* of EUR 30 billion in Period 1.

Step 1 under Article 2(d)(i): 10% of the Adjusted Revenues of EUR 100 billion are the normal profits of EUR 10 billion for Covered Group A. Subtracting EUR 10 billion of normal profits from the adjusted profit before tax of EUR 30 billion would produce *excess profits* of EUR 20 billion for Covered Group A.

Step 2 under Article 2(d)(ii): 25% of the *excess profits* would be EUR 5 billion (i.e., EUR 20 billion multiplied by 25%), being potentially available for allocation to market jurisdictions.

Step 3 under Article 5(1)(a): Supposing that EUR 60 billion of Group Revenues were sourced in Jurisdiction X, EUR 30 billion in Jurisdiction Y and EUR 10 billion in Jurisdiction Z, this would mean that EUR 3 billion of Amount A Profit would be allocated to Jurisdiction X, EUR 1.5 billion of Amount A Profit would be allocated to Jurisdiction Y and EUR 0.5 billion of Amount A Profit would be allocated to Jurisdiction Z.

(EUR billion)	Jurisdiction X	Jurisdiction Y	Jurisdiction Z
Sourced Revenues	EUR 60 billion	EUR 30 billion	EUR 10 billion
Amount A Profit allocated	EUR 3 billion (= EUR 5 X 60 / 100 billion)	EUR 1.5 billion (= EUR 5 X 30 / 100 billion)	EUR 0.5 billion (= EUR 5 X 10 / 100 billion)

207. Finally, the last step (contained in subparagraph (b)) applies the *marketing and distribution profits safe harbour adjustment* to potentially reduce the Amount A Profit of a Covered Group allocated to a Jurisdiction determined in subparagraph (a). This step caps *excess profits* allocated to a market jurisdiction through Amount A where *excess profits* of a Covered Group are already identified in the market jurisdiction through the process described in the subsequent paragraphs.

208. The *marketing and distribution profits safe harbour adjustment* can only potentially apply for a Jurisdiction where a de minimis threshold is reached. This threshold is satisfied in instances where the *adjusted elimination profit (or loss)* defined in paragraph 2(ff)] of the Covered Group in the Jurisdiction is equal to or greater than EUR 50 million.

Paragraph 2

209. Paragraph 2 contains a number of interconnected defined terms that operate in combination to determine the *marketing and distribution profits safe harbour adjustment*. The *marketing and distribution profits safe harbour adjustment* determined for purposes of paragraph 1(b) refers specifically to the term defined within subparagraph (a). The term *marketing and distribution profits safe harbour adjustment* defined in subparagraph (a) refers to the term *jurisdictional offsetting profits* defined in subparagraph (b). Then subparagraph (b) refers to the term *adjusted jurisdictional excess profits* defined in subparagraph (c), and the term *jurisdictional offset percentage* defined in subparagraph (d). Subparagraph (c) refers to the terms *adjusted elimination profit (or loss)* defined in subparagraph (f) and *jurisdictional depreciation and payroll* defined in Annex B Section 5(3) and subparagraph (d) refers to the term *low depreciation and payroll jurisdiction* defined in subparagraph (e).

Subparagraph (a) – marketing and distribution profits safe harbour adjustment

210. In cases where the de minimis threshold for the *marketing and distribution profits safe harbour adjustment* in paragraph 1(b) is satisfied, paragraph 2(a) provides that the *marketing and distribution profits safe harbour adjustment* will be determined as the lower of two amounts. The first amount is the amount determined in accordance with paragraph 1(a) (i.e., the Amount A Profit that would be allocable to a Jurisdiction, prior to calculating the *marketing and distribution profits safe harbour adjustment*). Therefore, a *marketing and distribution profits safe harbour adjustment* to reduce Amount A Profit allocations cannot exceed the pre-adjustment Amount A allocation to that Jurisdiction. The second amount is the *jurisdictional offsetting profits* of a Covered Group in a Jurisdiction.

211. For example, suppose the Amount A Profit allocable to Jurisdiction A prior to the *marketing and distribution profits safe harbour adjustment* is equal to EUR 200 million and the *jurisdictional offsetting profit* in Jurisdiction A is EUR 105 million. In this case, the “lower of” amount for purposes of paragraph 2(a) will be determined by subdivision (ii), resulting in a *marketing and distribution profits safe harbour adjustment* of EUR 105 million. Therefore, the Amount A Profit will be reduced by EUR 105 million, leaving a remaining EUR 95 million as the final Amount A Profit allocated to Jurisdiction A.

Subparagraph (b) – jurisdictional offsetting profits

212. The defined term *jurisdictional offsetting profits* referenced in paragraph 2(a)(ii) is provided in paragraph 2(b). The *jurisdictional offsetting profits* of a Covered Group in a Jurisdiction for a Period are determined by multiplying the *adjusted jurisdictional excess profits* of a Covered Group in a Jurisdiction (defined in paragraph 2(c)) by the *jurisdictional offset percentage* (defined in paragraph 2(d)).

213. For instance, continuing with the example in paragraph 211, if the *adjusted jurisdictional excess profit* in Jurisdiction A is EUR 300 million, and the *jurisdictional offset percentage* is 35 per cent, then the *jurisdictional offsetting profits* would be EUR 105 million (i.e., 35 per cent X EUR 300 million).

Subparagraph (c) – adjusted jurisdictional excess profits

214. The *adjusted jurisdictional excess profits* referenced in paragraph 2(b) is defined in turn at paragraph 2(c). The *adjusted jurisdictional excess profit* of a Covered Group in a Jurisdiction is equal to the higher of zero or the defined *jurisdictional excess profit* measure taken into account for the *marketing and distribution profits safe harbour adjustment* (i.e., the *adjusted elimination profit (or loss)*) (refer paragraph 225 below) minus the applicable *jurisdictional normal profit determination* for that Jurisdiction).

215. The applicable *jurisdictional normal profit determination* for a Jurisdiction will be the greater of two numbers determined for that Covered Group in that Jurisdiction. The first number is derived based on a Return on Jurisdictional Depreciation and Payroll and included in clause (A). It is calculated as the Elimination Threshold Return on Depreciation and Payroll defined in Article 2(n) of the Covered Group multiplied by the *jurisdictional depreciation and payroll* defined in Annex B Section 5(3) of the Covered Group in the Jurisdiction for the Period. The second number is derived based on a return on jurisdictional Sourced Revenues. It is calculated as 3 per cent of the Adjusted Revenues of the Covered Group that are sourced under Article 6 to the Jurisdiction for the Period. In any instance where the applicable *adjusted elimination profit (or loss)* is less than the normal profit determination the *adjusted jurisdictional excess profits* amount will be zero under subparagraph (c)(i).

Box 6. Example – Application of different metrics to identify adjusted jurisdictional excess profit (Article(2)(c))

Basic Facts for the Example

For purposes of this example, assume that Group A which operates in Jurisdictions X and Y has an Elimination Threshold Return on Depreciation and Payroll of 200%. Relevant jurisdictional information is set out below. In this example, Jurisdiction Y has a lower *jurisdictional depreciation and payroll* (i.e., EUR 10 million) compared to that of Jurisdiction X (i.e., EUR 20 million), although both jurisdictions have the same amount of Sourced Revenues (i.e., EUR 1 billion) and *adjusted elimination profit (or loss)* (i.e., EUR 50 million).

	Jurisdiction X	Jurisdiction Y
Sourced Revenues	EUR 1 billion	EUR 1 billion
Jurisdictional depreciation and payroll	EUR 20 million	EUR 10 million
Adjusted elimination profit (or loss)	EUR 50 million	EUR 50 million

Identifying the applicable metrics

In this instance, for Jurisdiction X, the Return on Depreciation and Payroll based metric per paragraph 2(c)(ii)(A) would be EUR 40 million (i.e., *jurisdictional depreciation and payroll* of EUR 20 million multiplied by the Elimination Threshold Return on Depreciation and Payroll of 200%), and the return on revenues based metric per paragraph 2(c)(ii)(B) would be EUR 30 million (i.e., Sourced Revenues of EUR 1 billion multiplied by 3%). The applicable normal profit threshold for Jurisdiction X would be EUR 40 million, which is the greater of the two metrics calculated. Thus, for Jurisdiction X, the metric based on the Return on Depreciation and Payroll per paragraph 2(c)(ii)(A) would be applicable to identify *adjusted jurisdictional excess profit*.

In contrast, for Jurisdiction Y, which has a lower level of Jurisdictional Depreciation and Payroll than Jurisdiction X, the applicable normal profit threshold would be different. For Jurisdiction Y, the Return on Depreciation and Payroll -based metric per paragraph 2(c)(ii)(A) would be EUR 20 million (i.e., *jurisdictional depreciation and payroll* of EUR 10 million multiplied by the Elimination Threshold Return on Depreciation and Payroll of 200%), which is lower than that of Jurisdiction X. The return on the revenue-based metric for Jurisdiction Y would be the same as that of Jurisdiction X (i.e., EUR 30 million). The greater of the two metrics would be EUR 30 million, which is the metric based on the return on revenues per paragraph 2(c)(ii)(B), and would be the applicable normal profit threshold for Jurisdiction Y.

	Jurisdiction X	Jurisdiction Y
Return on Depreciation and Payroll based metric (paragraph 2(c)(ii)(A))	EUR 40 million (= EUR 20 million X 200%)	EUR 20 million (= EUR 10 million X 200%)
Return on revenues based metric (paragraph 2(c)(ii)(B))	EUR 30 million (= EUR 1 billion X 3%)	EUR 30 million (= EUR 1 billion X 3%)
Applicable normal profit threshold	EUR 40 million (RODP based metric)	EUR 30 million (ROR based metric)

Calculating adjusted jurisdictional excess profits with the metric

After calculating the applicable metrics, *adjusted jurisdictional excess profits* are identified by subtracting the normal profit calculated using the applicable metrics identified above from the *adjusted elimination profit (or loss)*. In this example, the *adjusted jurisdictional excess profits* in Jurisdiction X

would be calculated as EUR 10 million, by subtracting the applicable normal profit threshold in Jurisdiction X of EUR 40 million from the *adjusted elimination profit (or loss)* in Jurisdiction X of EUR 50 million. For Jurisdiction Y, *adjusted jurisdictional excess profits* would be calculated as equal to EUR 20 million by subtracting the applicable normal profit threshold in Jurisdiction Y of EUR 30 million from the *adjusted elimination profit (or loss)* in Jurisdiction Y of EUR 50 million.

	Jurisdiction X	Jurisdiction Y
Adjusted elimination profit (or loss)	EUR 50 million	EUR 50 million
Less applicable normal profit threshold	EUR 40 million	EUR 30 million
Adjusted jurisdictional excess profit	EUR 10 million	EUR 20 million

If, for example, the *adjusted elimination profit (or loss)* had instead been calculated as EUR 25 million for both Jurisdiction X and Y, then the *adjusted jurisdictional excess profits* of both Jurisdiction X and Y would have equalled zero because the applicable normal profit threshold of EUR 40 million and EUR 30 million respectively exceeds the *adjusted elimination profit* of EUR 25 million of each Jurisdiction.

Subparagraph (d) – jurisdictional offset percentage

216. The *jurisdictional offset percentage* referred to in subparagraph (b) to calculate the *jurisdictional offsetting profits* differs from Jurisdiction to Jurisdiction, and subparagraph (d) specifies the percentage that applies in each case. There are three categories of Jurisdictions where differing *jurisdictional offset percentage* (i.e., 90 per cent, 25 per cent, or 35 per cent) applies.

217. The first criterion to categorise Jurisdictions is whether they satisfy the definition of a *low depreciation and payroll jurisdiction*, as defined in subparagraph (e). Subparagraph (d)(i) provides that the *jurisdictional offset percentage* shall be 90 per cent for all *low depreciation and payroll jurisdictions*. Examples of determining whether a Jurisdiction is a *low depreciation and payroll jurisdiction* and applying the *jurisdictional offset percentage* could be found in paragraphs 223 and 224.

218. Subparagraph (d)(ii) provides that the *jurisdictional offset percentage* shall be either 25 or 35 per cent in cases other than those included in subdivision (i). Under subdivision (ii), different 'lower' *jurisdictional offset percentage* would be applicable depending on a Jurisdiction's profile. If the Jurisdiction is a Lower Income Jurisdiction (as defined in Article 2(dd)) then *the jurisdictional offset percentage* shall be 25 per cent. Otherwise, the percentage shall be 35 per cent. Examples of applying the *jurisdictional offset percentage* depending on different categories of Jurisdictions could be found in paragraphs 223 and 224.

Subparagraph (e) – low depreciation and payroll jurisdiction

219. The defined term *low depreciation and payroll jurisdiction* is relevant for determining the applicable *jurisdictional offset percentage* for purposes of subparagraph (d). It is also relevant for determining the Withholding Tax Upward Adjustment for purposes of Annex B Section 6(1).

220. For a Covered Group for a Period, a Jurisdiction will be a *low depreciation and payroll jurisdiction* where its ratio of *jurisdictional depreciation and payroll* (defined in Annex B Section 5(2)) to "sourced revenue" (i.e. Adjusted Revenues of the Covered Group that are sourced under Article 6 to the Jurisdiction for the Period)" falls below the applicable threshold.

221. The *jurisdictional depreciation and payroll* divided by the “sourced revenue” of a Covered Group in a given Jurisdiction under Amount A revenue sourcing rule (i.e., “Jurisdictional DP to Sales Ratio”), would be compared with the threshold identified above to determine whether that Jurisdiction satisfies the criteria to be a *low depreciation and payroll jurisdiction*.

222. This jurisdictional outcome is compared to the Group level threshold is determined to be equal to 75 per cent multiplied by the Covered Group’s ratio of ‘depreciation and payroll’ to ‘sourced revenues (or sales)’ under the Amount A revenue sourcing rules in Article 6 (i.e., “Group DP to Sales Ratio”) at a Group level. In other words, the ratio would be calculated by taking the sum of the Covered Group’s *accounting depreciation* (defined in Annex B Section 5(5)(a)) and *accounting payroll* (defined in Annex B(5)(a) Section 5) for the Period as the numerator and dividing it by the Adjusted Revenues (defined in Article 2(c)) for the Covered Group for the Period, with the resulting ratio then multiplied by 75 per cent. For instance, assuming the Covered Group’s Adjusted Revenues were EUR 50 billion, and the sum of the Covered Group’s *accounting depreciation* and *accounting payroll* were EUR 8 billion, then the Covered Group DP to Sales Ratio would equal to 16% (= EUR 8 billion / EUR 50 billion), and 75% of the Group ratio would be 12% (=75% X 16%).

223. If Jurisdiction A’s *jurisdictional depreciation and payroll* is EUR 1 million and the Adjusted Revenues of the Covered Group to Jurisdiction A is EUR 10 million, then Jurisdiction A’s Jurisdictional DP to Sales Ratio would be 10% (= EUR 1 million / EUR 10 million). Jurisdiction A would qualify for a *low depreciation and payroll jurisdiction* because its Jurisdictional DP to Sales Ratio is lower than 75% of the Group ratio calculated in paragraph 222 (i.e., 10% < 12%). As a result, the *jurisdictional offset percentage* of 90 per cent (under subparagraph (d)(i)) would apply to Jurisdiction A. The classification of a Jurisdiction as a *low depreciation and payroll jurisdiction* will also be relevant for purposes of the *withholding tax upward adjustment reduction factor* (defined in Annex B Section 6(6) and discussed from paragraph 1577).

224. As another example, if Jurisdiction B’s *jurisdictional depreciation and payroll* is EUR 2 million with the same amount of sourced revenue as Jurisdiction A, then Jurisdiction B’s Jurisdictional DP to Sales Ratio would be 20% (= EUR 2 million / EUR 10 million). Since this ratio is higher than the Group ratio (i.e., 20% > 12%), Jurisdiction B would not qualify for a *low depreciation and payroll jurisdiction*. As a result, the lower *jurisdictional offset percentage* of 25 or 35 per cent (under subparagraph (d)(ii)) would apply. If Jurisdiction B satisfied the definition of a Lower Income Jurisdiction, then 25 per cent would apply to Jurisdiction B as the *jurisdictional offset percentage*. Otherwise, 35 per cent would apply to Jurisdiction B.

Subparagraph (f) – adjusted elimination profit (or loss)

225. The *adjusted elimination profit (or loss)* referred to in subparagraph (c)(ii) is defined in subparagraph (f). For a Covered Group in a Jurisdiction for a Period this amount is equal to the sum of Elimination Profit (or Loss) defined in Annex B Section 4 and the Withholding Tax Upward Adjustment defined in Annex B Section 6(1).

Article 6 – Sources of Adjusted Revenues

226. The rules related to the sources of Adjusted Revenues (which are referred to in this Explanatory Statement as “revenue sourcing rules”) are set out in three parts of the Convention.

- Article 6 sets out the revenue sourcing rules of general application.
- Article 7 sets out the revenue sourcing principles for each category of Adjusted Revenues.

- Annex D sets out more detailed rules for applying the revenue sourcing rules contained in the Articles.

227. These revenue sourcing rules, and the methods used to identify the source Jurisdiction, are applicable only for the Convention. They do not apply or have any implication beyond the Convention, such as any implication for determining the source of Adjusted Revenues or the character of Adjusted Revenues for purposes of existing tax rules, or any other issue outside of the Convention. As such, the outcomes that apply under these revenue sourcing rules cannot be the basis for a re-assessment of a Covered Group Entity's tax position under existing tax rules.

Paragraph 1

228. Paragraph 1 introduces the revenue sourcing Article. It provides that the rules contained in Articles 6 and 7 and Annex D apply to determine the Jurisdiction in which Adjusted Revenues are treated as arising for purposes of the Convention. The combined effect of those provisions ensures that all Adjusted Revenues are to be sourced.

229. Paragraph 1 sets out three related principles that apply for the purpose of determining where Adjusted Revenues are treated as arising. These rules provide that the source of Adjusted Revenues is determined by reference to categories and relate to how categories of Adjusted Revenues are determined. These rules apply for the purpose of revenue sourcing for purposes of the Convention. As such, categorisation undertaken to comply with these rules does not have any implication for categorisation or characterisation issues that may arise other than for purposes of the Convention (for example, under domestic law or in connection with a double tax convention). The determination for the Convention based on the new definitions contained in the Convention and the Explanatory Statement therefore cannot have any legal connection to determinations under different provisions. For the same reason, determinations made under domestic law (other than domestic law implementing the obligations in the Convention) are not relevant in considering the categorisation under these revenue sourcing rules.

Subparagraph (a): Categories

230. Subparagraph (a) provides that the sources of Adjusted Revenues are determined separately for each category of those revenues, which are identified in Article 7. This is necessary because the identification of the market Jurisdiction, and the information to be used to fulfil the sourcing requirement, are designed to reflect the particular nature of the Adjusted Revenues earned. Those categories are: finished goods; digital content; components; services; *intangible property* and user data; *immovable property*; government grants; and non-customer revenues.

231. Each of the categories are defined. In many cases, it will be clear which category applies, based on the definition. For example, a sale of a car will be a sale of a finished good, a sale of a semi-conductor will likely be a sale of a component (unless it is a dual use component as discussed in paragraph 2222), and the provision of cloud computing services will be the provision of other services. The definitions are designed to reduce overlap between the categories.

Box 7. Overview – Definitions of the categories of Adjusted Revenues

The following decision tree may assist in explaining the differences in the defined categories. The use of this aide is not mandatory, and a Covered Group need not use it where the categorisation was already clear from the definition itself. In using this aide, a Covered Group would stop at the point that it obtained the answer as to the category, and would not need to answer all nine questions. In answering the questions below, a Covered Group would take into account the application of the ordinary or predominant character principles.

1. Are the Adjusted Revenues derived from a customer?
 - If not, then it will be either government grants or non-customer revenues.
2. Is there a transfer of ownership (i.e. a perpetual transfer of substantially all rights) in a physical item?
 - If so, then the category will either be finished goods, components or *immovable property* (go to point 3).
 - If not, then the category will either be digital content, services, *immovable property*, or *intangible property* (go to point 5).
3. Is the physical item *immovable property* (where *immovable property* includes land, buildings, property accessory to land and buildings, natural resources, livestock and equipment used in agriculture and forestry)?
 - If so, then it is *immovable property*.
 - If not, then it is either finished goods or components.
4. Is the physical item B2B transfer of an item that will be used as an enduring input into a separate good that will be for sale?
 - If so, it is a component.
 - If not, then it is a finished good.
5. Is there a transfer of rights in respect of *immovable property*?
 - If so, it is *immovable property*.
6. Is there a transfer of a right to use a physical item without a transfer of ownership?
 - If so, then the category is services connected to tangible property.
7. If not, does one of the other specific definitions of services apply in Article 7(1)(d)(i) – (viii)?
 - If not, then it is either digital content, another service covered by Article 7(1)(d)(ix) or

intangible property.

8. Has the customer received a right to access content through digital means, including a customer who is permitted to further distribute that content outside its own organisation but not including those with a right to modify that content to develop new digital content?
 - If so, then the category is digital content.
 - If not, then the category will be other services or *intangible property*.

9. Does the customer receive *intangible property* in return for the Adjusted Revenues? This would be the case if the *intangible property* existed before the *transaction*; the recipient has the right to use, control, develop or otherwise monetise the *intangible property* in its own commercial activities the *intangible property* for their own account; and the grantor is not required to play a part in the use of the *intangible property* by the customer. This would include, but not be limited to, the granting of a right to use a patent, copyright or trademark to a business for use as an input into their own product or service.
 - If so, then the category will be *intangible property*.
 - If not, then it is another service covered by Article 7(1)(d)(ix).

Subparagraph (b): Determination of categories

232. Subparagraph (b) provides that those definitions of each category are applied based on the ordinary or predominant character of the *transactions* from which they derive, determined on the basis of their substance, irrespective of legal form.

233. The categorisation analysis is premised on there being a *transaction*. A definition of the term *transaction* has been included to confirm that what is treated as a *transaction* for the purposes of the revenue sourcing rules is primarily determined by reference to the price charged to the customer. That term would generally look to the contractual arrangement from which the Covered Group derives the Adjusted Revenues, as described and separately priced in the contractual documentation. For example, if a Covered Group sells 100 widgets to a customer at a price of EUR 1 per unit, that arrangement comprises 100 *transactions*. However, where the component parts of the offering are separately described in the contractual documentation, but are not separately priced, there is only one *transaction*. For example, where a cloud computing service includes cloud computing services and the provision of an on-site server to support the cloud computing service, those two elements would be separately described in order to give effect to the contract, but if only one price charged (i.e., the price for the cloud service and the price for the on-site server are not separately detailed), the arrangement would comprise one *transaction*, to which the predominant character analysis set out below would apply to determine the character of the *transaction*. It should be noted that where a *transaction* from which Adjusted Revenues are derived is unbundled for accounting purposes into different component parts, the taxpayer is not required to re-bundle the components of the *transaction* for the purpose of determining the “predominant character” and may source each unbundled component part identified for accounting purposes separately. Although the contract would generally represent the *transaction*, the meaning of *transaction* would depend on the commercial circumstances.

234. The definition of *transaction* goes on to provide that an arrangement will be treated as more than one *transaction* if it is reasonable to conclude, having regard to all facts and circumstances, that one of the principal purposes of charging a single price for a bundle of items was to artificially manipulate the categorisation of the Adjusted Revenues derived from that bundle whether in whole or in part. This aspect of the definition of *transaction* is an exception to the general definition of *transaction* and is designed to operate as a specific and targeted anti-abuse measure which should only apply in limited cases where the conditions are satisfied. It is intended to deter potential planning opportunities that would otherwise artificially manipulate the outcomes under the revenue sourcing rules. Absent the inclusion of the anti-abuse element in the definition of *transaction*, incentives may exist for Covered Groups to price arrangements in a particular way with a view to achieving a particular categorisation for revenue sourcing purposes. This part of the definition includes a purpose test that will distinguish cases involving genuine non-tax commercial pricing arrangements from pricing arrangements that are intended to artificially manipulate the categorisation of Adjusted Revenues.

235. In order for the rule to apply, the *transaction* must relate to a bundle of items that if priced separately would be categorised differently. For example, the rule could not apply to a *transaction* for the sale of a large number of finished goods as in all cases, the Adjusted Revenues will be regarded as derived from finished goods.

236. Further, the pricing must artificially manipulate the categorisation of the Adjusted Revenues whether in whole or in part. This requires the pricing to be contrived and unrepresentative of the commercial dealings up to the point the invoice was issued. For example, if the Covered Group ran two independent negotiations with a customer in respect of the sale of a finished good and a service, subsequently invoicing the customer using a single invoice showing a single price would not appear to reflect the commercial dealings.

237. The categorisation of Adjusted Revenues will be considered to be artificially manipulated where items that would otherwise be priced separately are priced as a single *transaction* to:

- achieve a particular ordinary or predominant character;
- override the monetary limits included in the supplementary transactions rule; or
- modify the applicable categorisation of Adjusted Revenues under the revenue sourcing rules in any way contrary to their intent.

238. The anti-abuse rule will only apply in cases where it is reasonable to conclude, having regard to all relevant facts and circumstances, that artificially manipulating the categorisation of Adjusted Revenues was a principal purpose of the pricing. The application of the anti-abuse element cannot be prevented by merely asserting that a pricing arrangement was not intended to artificially manipulate the categorisation of Adjusted Revenues. Likewise, the application of the anti-abuse element cannot be justified by merely asserting that one of the principal purposes of a pricing arrangement was to artificially manipulate the categorisation of Adjusted Revenues. All of the evidence must be weighed to determine whether it is reasonable to conclude that a pricing arrangement has such purpose. The determination requires reasonableness, suggesting that the possibility of different interpretations of the events must be objectively considered.

239. To determine whether one of the principal purposes of the pricing was to artificially manipulate the categorisation of Adjusted Revenues, it is necessary to undertake an objective analysis of the pricing arrangement including the aims and objects of Covered Group in determining that pricing arrangement. Identifying the purposes of a pricing arrangement is a question of fact which can only be answered by

considering all circumstances pertaining to the arrangement on a case-by-case basis. It is not necessary to find conclusive proof of the intent of the persons concerned, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the principal purposes of the pricing arrangement was to artificially manipulate the categorisation of the Adjusted Revenues.

240. The reference to “one of the principal purposes” means that artificially manipulating the categorisation need not be the sole or dominant purpose of a particular pricing arrangement. Rather, it is sufficient that where there is more than one principal purpose, at least one of those principal purposes of the pricing arrangement was to artificially manipulate the categorisation of the Adjusted Revenues. For example, if a Covered Group separately managed price negotiations with the same customer for two unrelated items (e.g. a finished good and a service) but invoiced the customer for both items using a single invoice and showing a single price, so that the arrangement was treated as a single *transaction* and categorised as such, although the pricing may have more than one principal purpose which may include a commercial one, it cannot be automatically concluded that the principal purposes of the pricing was not to artificially manipulate the categorisation of Adjusted Revenues. If it is reasonable to conclude, having regard to all relevant facts and circumstances (e.g. the customer relationship, internal management considerations and commercial objectives), that artificially manipulating the categorisation of Adjusted Revenues was not a principal consideration and would not have justified the pricing arrangement, the anti-abuse rule will not apply. For example, a Covered Group might bundle the sale of a number of other items together to offer a single discounted price to the customer to incentivise them to complete the overall *transaction*. In such a case, it would be reasonable to conclude that artificially manipulating the categorisation of Adjusted Revenues was not a principal purpose of the pricing. Where pricing is determined by commercial factors only, it is not reasonable to conclude that a principal purpose of the pricing was to artificially manipulate the categorisation.

241. If it is determined that one of the principal purposes of charging a single price for a bundle of items was to artificially manipulate the categorisation of the Adjusted Revenues derived from that bundle whether in whole or in part., the provision of each individual item that is part of the bundle must be treated as a separate *transaction* and separately categorised according to its ordinary character.

Box 8. Example – Meaning of transaction

The following example illustrates the principles for identifying the *transaction*.

A Covered Group has an on-going relationship with a long-standing business customer to whom it sells finished goods and unrelated consultancy services. For the previous five years it had invoiced the customer separately for the finished goods (which were delivered to a number of different Jurisdictions for the customer) and the consultancy services (which were usually three times the price of the finished goods). However, under a new pricing arrangement, the Covered Group bundles the finished goods and consultancy services together and the invoice for EUR 15 million is issued to the subsidiary of the business customer that is located in a low tax Jurisdiction that has not previously been invoiced for either the consultancy services or the finished goods. In addition, the price is discounted when compared to the prices historically charged when the items were separately invoiced.

If the arrangement was to be treated as a single *transaction* (by reason of a single price being issued to the customer), the predominant nature of the *transaction* would result in an “other service” categorisation (as the finished goods element is subsumed in the predominant character of the *transaction*). As the customer is not a *specified large customer* of the Covered Group, the source would be determined using the customer’s billing address (as opposed to using the delivery address for the

finished goods). As the billing address is in a low tax Jurisdiction, the Covered Group pays a lower level of tax on the arrangement when it is treated as a single *transaction* than it would if it was treated as a number of *transactions*.

The bundling of the unrelated elements combined with billing an entity located in a low tax Jurisdiction that had not previously been party to the *transactions* with the Covered Group and the otherwise unexplained discount to the long-standing customer could indicate that the pricing arrangement was artificial and that one of the principal purposes of the new pricing arrangement was to change the categorisation of Adjusted Revenues derived from the sale of the finished goods. In the absence of evidence to the contrary (e.g., commercial factors explaining the reasons for the changes), it would be reasonable to conclude that one of the principal purposes of the pricing was to artificially manipulate the categorisation of the Adjusted Revenues. As such, the anti-abuse rule could be applied to treat the arrangement as comprising two separate *transactions*, one for finished goods and the second for consultancy services. The Adjusted Revenues derived from the arrangement would be split between the two *transactions*.

242. Article 6(1)(b) refers to the character of the underlying *transactions* (plural), and not to each individual singular *transaction*. It is accepted that seeking to apply the test to each individual *transaction* would be disproportionately burdensome for Covered Groups whose number of *transactions* would often be millions if not billions. Therefore, Covered Groups are permitted to aggregate *transactions* for the purpose of categorising them. How *transactions* are aggregated will depend on the Covered Group, its business lines, customer base, distribution models and reporting systems. Aggregating *transactions* by customer would be reasonable where the customer bought the same item (or items of the same single category) from a Covered Group in a Period. It might also be reasonable to aggregate *transactions* by groups of customers in a Jurisdiction, for example, all finished goods sold to retailers in Jurisdiction A. Aggregating *transactions* by product would also be a reasonable approach where the product is always intended to be for the same type of use. In addition, the reference to the ordinary or predominant character signifies that the determination is made by reference to the overall nature of those underlying *transactions* in totality having regard to the usual, common, or expected context in which they take place. As such, the categorisation is not required as a separate determination for each individual *transaction*, but can rather apply to groups of *transactions* that are of the same type. For example, all of the sales of consumer products made at a Covered Group's retail store involve the same type of product being sold in the same context, and would all be categorised as finished goods, and the Covered Group does not need to analyse and document the categorisation of each sale of each consumer product separately. The Covered Group would need to document its approach to aggregation to demonstrate that such approach was reasonable.

243. There are four additional elements to this rule: the meaning of character; the meaning of ordinary; the meaning of predominant; and the application of the substance over the legal form. Each is discussed in turn.

Character

244. Character is determined by reference to the benefit that the Covered Group intends for the customer to acquire in paying for the good, content, service or right. In combination with the "ordinary or predominant" test and the "substance over form" test, it means that the character is tested with regard to the benefit that the customer is intended to receive by the Covered Group as the outcome of the *transaction*. In this regard, the test is focused on expected, overall, practical outcomes. It asks what in practical terms should have changed for the customer because of that type of *transaction*. This means that the benefit that the customer is intended by the Covered Group to acquire may be identified by reference

to the expected change in the customer's position; the action the customer is expected to take after that type of *transaction*; or what that type of *transaction* should enable the customer to enjoy.

245. It is not determined by the customer's subjective intentions, but what practical benefit the Covered Group has designed the customer to receive. This means that when applying the definition of each category of Adjusted Revenues contained in Article 7, unusual *transactions* where the customer uses the item in a way other than the Covered Group intended can be disregarded in favour of the overall usual, common, or expected nature.

246. For example, a Covered Group selling microchips may possibly have a *transaction* with an individual consumer who assembles and restores computers as a hobby; but the intention of the Covered Group in selling microchips is to sell to businesses a component part of other electronics goods. The Covered Group is not required to investigate the subjective intention of each customer and separately source the occasional *transaction* based on a different categorisation in light of an individual customer's intentions. A further implication of this is that a Covered Group cannot claim that it is impossible to categorise its Adjusted Revenues because of the possibility of unusual uses of a product or service by its customers, but rather that the Covered Group must fulfil its obligations based on its own intentions. As such, if a Covered Group that sold microchips began to target the consumer-hobbyist base by dedicating time of sales and marketing personnel to expanding distribution to such customers, that should be reflected in the categorisation of Adjusted Revenues from sales of microchips. Those intended for sale to consumer-hobbyists would be of a different character to the remainder of the microchip sales (even if they represented very small percentage of overall Adjusted Revenues from microchips) and would be separately characterised.

Ordinary character

247. "Ordinary" character means the usual, common, or expected character. This means that the test is applied based on what an ordinary person would observe, rather than a strict, legalistic or technical test analysing the individual elements of how the deliverable was transferred or made functional.

Box 9. Examples – Ordinary character

The following examples illustrate the principles for categorising Adjusted Revenues using the concept of ordinary character.

Example 1

The Covered Group sells pharmaceutical drugs. Pharmaceutical drugs are tangible goods, and are not *immovable property*, meaning that they can only be finished goods or components. The practical outcome that the Covered Group intends the customer to obtain is the tangible medicine to treat their illness. The ordinary understanding of the acquisition of drugs is that of a finished good, and the Covered Group does not intend for the customer to acquire rights to the underlying intellectual property. The fact that a large part of the value of the drug is attributable to the embedded intellectual property (i.e. the patent over the active ingredient) does not affect the character.

Example 2

The Covered Group intermediates taxi rides between passengers and drivers and generates Adjusted Revenues from service fees on the *transactions* between passenger and driver. The underlying service, which is the ride itself, is categorised as a *location-specific service*. The practical outcome that the Covered Group intends the customer to obtain is to match passengers with drivers so that they can agree a fare in return for a taxi ride. This is the ordinary understanding of that service, even if a technical analysis of the elements of the activities of the Covered Group may be limited to the provision of information and the provision of the application. As such, the Adjusted Revenues of the Covered Group are categorised as those from an online intermediation service.

Predominant character

248. In many cases, the ordinary character will be clear. Where that is the case, there is no need to apply a separate analysis of the “predominant” character.

249. However, there will be cases where there is not only one ordinary character to the underlying *transactions*. This would include cases where Adjusted Revenues fall under more than one category (e.g. both a service and a good) or where there is more than one element to a good, service or right but they are not separately itemised, severable or charged to the customer. In such cases, a Covered Group should determine the character based on the predominant character.

250. Predominant means the more important or main part. This means that incidental, ancillary or supporting aspects facilitating the *transaction* do not govern the character. This is the case even where such incidental, ancillary or supporting aspects are frequently present.

251. For example, in downloading an e-book, the *transaction* has characteristics typical of more than one characterisation. The enjoyment of the e-book is the main, practical benefit that the customer is expected to receive as the outcome of the *transaction*. However, to facilitate that enjoyment, some limited transfer of copyright may be granted. There is however a single *transaction*, the predominant character of which is digital content, and not *intangible property*.

Box 10. Examples – Predominant character

The following examples illustrate the principles for categorising Adjusted Revenues using the concept of predominant character.

Example 1

The Covered Group provides software over the internet, which comes with an online helpdesk function that is not separately charged. The helpdesk service is a small and supportive part of the *transaction*, which cannot be used on a standalone basis, and which is not separable from the provision of software. The provision of the software (which is digital content) is the predominant character of the *transaction* notwithstanding the helpdesk aspect of the *transaction* which, viewed in isolation, might otherwise seem to have a service character.

Example 2

The Covered Group franchises its fast food restaurant. Although a franchise arrangement comprises a range of elements, and may include the provision of physical products such as ingredients to make the food, a service agreement to provide operational advice, or a lease agreement to use *immovable property*, it is usually the case that the most important part of the arrangement is the right to use the *intangible property* of the franchisor, typically including brand names, trademarks, logos and know-how. However, where such other aspects (such as sale of ingredients, operational services, or lease agreement) are separately invoiced, or separately priced in the one contract, the analysis is not one of predominance, as they are clearly separate *transactions* to which the categorisation rule applies separately. However, if certain conditions are met, the rule for supplementary revenues (below) could be used to source all items together, with the main Adjusted Revenues being the *intangible property*.

Substance over form

252. In determining the ordinary or predominant character, the substance of the underlying *transaction* governs the *transaction*, as opposed to the legal form.

253. The principle of substance over legal form means that the particular legal arrangement implemented and the labels used to describe that arrangement to transfer the good, content, service or right is not determinative; but that the character is determined by reference to the nature of the good, content, service or right (as described above).

254. In many cases, the substance and the form should align, and no analysis or documentation would be required on this point. However, if the ordinary or predominant character of Adjusted Revenues is ambiguous, the substance of the *transactions* from which the Adjusted Revenues were derived, rather than their legal form would determine the appropriate categorisation, and an explanation of the approach taken would be required in the documentation. This rule is intended to complement the requirement to determine the ordinary or predominant character of *transactions*, and serves to ensure that in analysing the ordinary or predominant character, the legal form takes on only secondary importance. That is not to suggest that the legal form should be ignored, rather, if it is inconsistent with the ordinary or predominant character and the substance of the *transactions* from which the Adjusted Revenues are derived, those factors will take priority in categorising the Adjusted Revenues.

255. The substance of a *transaction* can be determined as evidenced or inferred from the commercial arrangements, including marketing information, having regard to:

- the purpose of the Covered Group, ascertained objectively by reference to the broader factual context;
- the expected commercial benefits to the customer, as designed by the Covered Group; and
- the rights and obligations of the Covered Group and the customer.

Box 11. Example – Substance over form

The following example illustrates the principles for categorising Adjusted Revenues using the concept of substance over form.

The Covered Group provides access to online entertainment content to an individual consumer. It is marketed as an entertainment streaming service. Legally it is documented as a licensing arrangement. The Adjusted Revenues are properly categorised as a digital content (and not as *intangible property*). This is because the character is determined by reference to what the Covered Group intends the customer to benefit from (which is the enjoyment of entertainment as opposed to benefiting from the acquisition of legal rights). The ordinary meaning understood by a typical customer of the service would be the enjoyment of the online content for entertainment. In this context, the legal form is not determinative and does not overturn this determination of the ordinary character. This could be demonstrated by the Covered Group using copies of marketing materials used to promote the streaming service.

Subparagraph (c): Analogous categories

256. Subparagraph (c) provides that the source of Adjusted Revenues not described in any of the categories set out in Article 7 shall be determined by reference to the most analogous category. This paragraph 1(c) recognises that the categorisation of certain Adjusted Revenues may not be apparent.

257. The rule provides a catch-all to require that a type of Adjusted Revenues that does not fit into one of the given categories be sourced by reference to its closest analogy. This ensures that all Adjusted Revenues continue to be sourced, even as business models evolve in advance of any necessary update to the rules. If this rule is applied by a Covered Group in a Period to categorise a particular set of *transactions*, that categorisation should consistently be applied in subsequent Periods unless a *review panel* or a *determination panel* disagrees that the categorisation is the most analogous (for example where they consider that another categorisation would give rise to more rational outcomes), a new category is subsequently added to the rules, or there is a change in the nature of the Adjusted Revenues that means a different category becomes more analogous.

258. In determining the most analogous category, the general categorisation rules contained in paragraph 1(b) above must be applied.

Paragraph 2

259. Paragraph 2 introduces the core principle underpinning the revenue sourcing rules, which is the use of a *reliable method* (defined in paragraph 3, discussed below). Paragraph 2 provides that each Party shall require the Group Entities of a Covered Group to apply a *reliable method* to determine the sources of all Adjusted Revenues of the Covered Group from each category of *transactions* in which it engages. In other words, the use of a *reliable method* is mandatory and if a certainty panel (or a tax administration if the Covered Group has not elected into the certainty process) considers that information is available to a Covered Group on the basis of which a *reliable method* could be applied, it may require the Covered Group to apply a *reliable method*.

260. Paragraph 2 further provides that where a Covered Group applies such a *reliable method* with respect to Adjusted Revenues derived from a category of *transactions* in which it engages, that *reliable method* will determine the source of those Adjusted Revenues. This means that provided that a Covered Group demonstrates that the approach taken to sourcing its Adjusted Revenues meets the principles of a *reliable method*, the approach will be accepted for the purpose of determining the source under the Convention. This is the case even if it was possible to use a different *reliable method* in a given case because a Covered Group is not required to prove that the specific approach taken is the most reliable method, only a *reliable method*. A Group will also have applied a *reliable method*, and therefore be within this paragraph 2, where it has applied a revised approach following a certainty process (in which case the *reliable method* is the one contained in a *comprehensive certainty outcome* following a request for *comprehensive certainty*) or following a request by a tax administration if the Covered Group has not elected into the certainty process.

261. This reflects the intention that the revenue sourcing rules will be applied on the basis of each Covered Group's facts and circumstances. This means that a Covered Group may use different information for sourcing one group of *transactions* than for another, and that one Covered Group may use different information to another Covered Group, even though it may be with respect to the same category of Adjusted Revenues. This recognises the different ways that a Covered Group might operate its business, and the different types of information available to it. It further reflects that the rule is not the "most reliable method;" rather, it accommodates different approaches to applying the rules, provided that such approaches are considered to be a *reliable method*. The test for what is considered a *reliable method* is contained in paragraph 3.

Paragraph 3

262. Paragraph 3 sets out the definitions for Article 6, Article 7 and Annex D. These are *reliable method* (subparagraph (a)); *reliable indicator* (subparagraph (b)); and *allocation key* (subparagraph (c)).

Reliable method

263. The term "reliable method" is defined in paragraph (a). It means a method that identifies where Adjusted Revenues arise using a *reliable indicator* (as defined in paragraph (b)) or, provided certain conditions are met, an *allocation key* (as defined in paragraph (c)). *Reliable indicators* are typically based on information generated by or acquired by the Covered Group. In order for information to be treated as a *reliable indicator*, it must be shown to be credible and relevant (as explained further under the definition of *reliable indicator*). The *allocation keys* are used in the absence of *reliable indicators* and the inclusion of *allocation keys* recognises that in some cases Covered Group will not have *reliable indicators* that can be used to source Adjusted Revenues. Paragraph 3 allows a Covered Group to use an *allocation key* where a *reliable indicator* cannot be found. This is different to the operation of the *allocation keys* under paragraph 4, which only applies where the group has failed to apply a *reliable method*. The revenue sourcing rules prioritise the use of *reliable indicators* over *allocation keys*.

264. Revenue sourcing of Adjusted Revenues for each Period is done with respect to the Period that Adjusted Revenues are recognised (in accordance with the relevant accounting standard), based on revenue recognition principles. This means that the assessment of whether a method is a *reliable method* is taken with respect to the information that was available for the Period when the Adjusted Revenues were recognised. As such, the subsequent availability of information does not reopen the determination of whether the approach was a *reliable method* for the earlier Period, and does not require an adjustment to the documentation filed and assessment of the tax imposed in connection with the Convention. For example, a Covered Group has a multi-year contract for the sale of components. Adjusted Revenues are recognised each year over the course of the contract, and not only at the end of the contract. The Covered

Group uses an *allocation key* for two years in accordance with the requirements for a *reliable method*, but finds another *reliable indicator* to use from year three. In this case, the Covered Group does not need to adjust its *reliable method* for the first two years.

265. There are a number of elements to the definition of *reliable method*.

Subdivision (i)

266. First, in subdivision (i), when a method other than an *allocation key* is used (i.e. the method is using indicators), the method must account for differences in the nature, quantity and prices of the goods, content, property, products or services that are sold, licensed or otherwise alienated, or provided by the Covered Group. This principle requires that in order to be reliable, the method must be accurately associating the correct amount of Adjusted Revenues to each market Jurisdiction. This will not be, in many cases, a foreign concept. It will likely be similar to how some Covered Groups' existing systems for inventory and invoicing will already be operating, for example, where it records the quantities or pricing differences between product lines in order to allocate the right Adjusted Revenues to the booking entity. This does not mean that all of the rules for revenue sourcing must apply on a transaction-by-transaction basis. It does mean that the systems must be designed to extract, aggregate and calculate the Adjusted Revenues associated with each market (based on the nature, quantities and pricing of products actually associated with that market).

267. For example, this principle would not be met by a system that simply aggregates the total Adjusted Revenues from a particular product line, and divides them equally between all markets, when in reality different amounts of products were sold at different price points in each market. It is a principle that is not designed to be prescriptive as to how the Covered Group complies with this principle. It is intended to provide flexibility in the way this principle is translated in the context of a Covered Group's particular circumstances. This is further supported by the documentation requirements required of a Covered Group, in particular as it relates to the *internal control framework* for revenue sourcing (see Article 19).

Subdivision (ii)

268. Subdivision (ii) of the definition of *reliable method* provides a simplification for sourcing certain Adjusted Revenues derived from two groups of *transactions* to which the categorisation rules can be applied separately where the second group of *transactions* would not have been entered into but for the first group of *transactions* ("supplementary revenues"). The first group of *transactions* must be similar to one another. That would require the subject matter of the *transactions* to be alike, from the same product family and relevant to the same business line (in that the same part of the Covered Group is responsible for the management of that part of the business). The "but for" test means that the *transactions* from which the supplementary revenues are derived are only entered into in connection with, and are conditional upon, the first group of *transactions*. In other words, this applies where the supplementary revenues are derived based on other *transactions* that are dependent on the first group of *transaction(s)*. There is no requirement for the other *transactions* to be entered into with the same customers as the first *transaction(s)* (although in many cases, they will) but it should be the case that without the first *transaction(s)*, the Covered Group would not or could not offer the goods, content, property, products or services that give rise to the supplementary revenues. Likewise, there is no requirement for the Covered Group to demonstrate that even if the separate sourcing rules were applied, they would be sourced to the same Jurisdiction (albeit by a different methodology that would need to be separately documented).

269. This rule for such supplementary revenues is included for convenience and to reduce administrative burdens. This is a different type of analysis to the rule in Article 6(1)(b), relating to the ordinary or predominant character test. Whereas the "predominant character" analysis described in Article 6(1)(b) applies where there is only one price charged and there is a need to decide which category that

transaction belongs to, the supplementary revenues rule applies where there are separately priced *transactions* which could be categorised using the rules and principles outlined in Article 6(1), but are then re-aggregated under one category given that the *transactions* are connected to each other.

270. It permits (but does not require) the Covered Group to apply the same revenue sourcing rules for the supplementary revenues as it does for the first group of Adjusted Revenues. The language in subdivision (ii) confirms that notwithstanding such a rule does not take into account the differences in the nature of the goods, content, property, products or services provided by the Covered Group, as required by subdivision (i), it will still be considered a *reliable method*, provided the following conditions are met, which provide for limitations on the size of the supplementary revenues.

271. The first condition, in clause (A), is that these supplementary revenues cannot exceed 15 per cent of the total Adjusted Revenues from the supplementary *transactions* and the first group of *transaction(s)* combined. This monetary cap is designed to ensure that the first group of *transaction(s)* (which will be governing source rule for the supplementary revenues) are the primary revenue generator of the combined *transactions*. This is tested separately for each group of connected *transactions* to which the Covered Group is applying the supplementary transactions rule.

272. The other size limitation, in clause (B), is that the total supplementary revenues cannot exceed 5 per cent of the Covered Group's Adjusted Revenues for the Period. This provides an overall cap on the use of this rule, for example, where the Covered Group uses the rule in respect of multiple groups of *transactions*.

273. Any Adjusted Revenues where the Covered Group exceeds these caps in clause (A) or (B) must be separately sourced using the ordinary rules in Articles 6 and 7 and Annex D in order to be a *reliable method*. In applying the rule for supplementary revenues, it is necessary to identify the relevant *transactions*. See paragraph 233 for a discussion of the meaning of *transaction*.

Box 12. Examples – Supplementary revenues

The following examples illustrate the application of supplementary revenues.

Example 1

The Covered Group derives Adjusted Revenues from *intangible property* that relates to a film. In order to promote this film, the Covered Group also developed merchandise (categorised as finished goods) that is sold in several cinemas where the film is screened. Although there may be some causal link between the sale of the merchandise and the screening of the film (and the associated Adjusted Revenues derived therefrom), the sale of the merchandise is not conditional upon the licensing, given that a person could purchase the merchandise without seeing the film. As such, the sale of the merchandise cannot be sourced using the rule for supplementary revenues, as it does not meet the test that such sales would not have been entered into but for the first group of *transactions*.

Example 2

The Covered Group sells automobiles, which are finished goods and are the only products generally sold by the Covered Group. However, it also provides customers financing options to purchase the Covered Group's automobiles, on which it earns interest. The financing portion could be separated, and would be categorised as other services. As the Covered Group is only legally permitted to provide financing for the purchase of the automobiles, the financing could not be provided on a standalone basis, but is only provided if there is a sale of an automobile. The financing is therefore in connection with, and conditional upon, the entry into the automobile sale *transactions*. In the Period, the Adjusted

Revenues from financing amount to not more than 15 per cent of the Adjusted Revenues earned from the sale of the automobiles and the customer financing combined and not more than 5 per cent of the total Adjusted Revenues of the Covered Group. As such, it can be considered as supplementary revenues. For administrative ease and given the interrelated nature of the *transactions*, the Adjusted Revenues from financing could be sourced in the same way as the sale of the automobile.

Example 3

The Covered Group sells its own food and beverages online, which can be collected by the customer. It also offers a home delivery service, on an annual subscription basis. The online sales of the food and beverages is categorised as finished goods sold directly by a Covered Group. The delivery service is categorised as a *location-specific service*, being a service performed at the location of the customer. The delivery subscription service would not be offered without the finished goods business, as the Covered Group only provides delivery of its own food and beverages, and not any third party items. The delivery service is therefore in connection with, and conditional upon, the sale of the food. In the Period, the Adjusted Revenues from the delivery service amount to more than 15 per cent of the Adjusted Revenues from the finished goods being delivered and the delivery service combined. The Covered Group may not have reached the second limit for using the rules for supplementary revenues (i.e., all supplementary revenues may be less than 5 per cent of the total Adjusted Revenues of the Covered Group). However, in this case the Adjusted Revenues from the delivery subscription cannot be considered as supplementary revenues, even though other parts of the test were met. The Adjusted Revenues from the delivery service are sourced using the rules for *location-specific services*, and the Adjusted Revenues from the finished goods are sourced using the rules for finished goods.

Example 4

A Covered Group offers a cloud computing service. Customers are billed monthly or quarterly based on their usage of the service. In a Period, the Covered Group typically derives EUR 10 billion from the sale of cloud computing services. This amount would be sourced as Adjusted Revenues from other services. A number of the cloud computing service customers acquire servers from the Covered Group. The servers are advertised for sale separately to the cloud computing service and are also sold to customers to whom the Covered Group does not provide these services. In a Period, the Covered Group typically derives EUR 4 billion from the sale of servers. This amount is sourced as Adjusted Revenues from finished goods.

As the Adjusted Revenues from the sales of servers are more than 15 per cent of the Adjusted Revenues from the sales of the cloud computing services and the servers combined, the Covered Group cannot use the supplementary revenues rule. In order to access the rule, the Covered Group adds the cost of servers sold to cloud computing customers to their periodic bills (rather than billing them separately) and does not show a separate price.

The bundling of the server and the cloud computing service in a single invoice in order to access the supplementary revenues rule is intended to change the categorisation that would otherwise apply to some of the Adjusted Revenues (those derived from the servers) and would fall within the anti-abuse element of the definition of *transaction*. In the absence of commercial factors explaining the reasons for the changes to the pricing arrangement which could be taken to demonstrate that the pricing arrangement is not artificial, the anti-abuse rule could be applied to treat the arrangements as comprising two separate *transactions*, one for sales of servers and the second for cloud computing services. The Adjusted Revenues derived from the arrangement would be split between the two *transactions*.

Subdivision (iii)

274. An *allocation key* may apply only with respect to Adjusted Revenues for which no source has been determined based on *reliable indicators*. This means that in cases where *reliable indicators* have been used to determine the source for all of the Adjusted Revenues in a given category, the *allocation key* will not be needed. However, if the source of some of the Adjusted Revenues in a given category was not determined on the basis of *reliable indicators*, the *allocation key* applies with respect to that remaining part. If the source of all of the Adjusted Revenues in a given category was not determined on the basis of *reliable indicators*, the *allocation key* applies with respect to all of those revenues.

275. Subdivision (iii) of the definition of *reliable method* sets out three conditions under which the use of an *allocation key* will be a *reliable method*. All three conditions must be satisfied before the use of the *allocation key* will be a *reliable method*.

276. First, subdivision (iii)(A) provides that an *allocation key* may only be used if it is expressly permitted for that category in Annex D. This reflects that not all types of Adjusted Revenues require this fall-back method of an *allocation key*.

277. Second, subdivision (iii)(B) provides that an *allocation key* may only be used if the Covered Group demonstrates that it has taken reasonable steps to identify a *reliable indicator* for the relevant category of Adjusted Revenues among the indicators enumerated in Annex D (“enumerated reliable indicators”) and has concluded that no such enumerated *reliable indicator* is available in respect of (part of) its Adjusted Revenues. This means that the reasonable steps obligation only relates to those specific indicators listed in Annex D, but does not extend to any other data points (referred to in the discussion of *reliable indicator* below as “another reliable indicator” or an “alternative reliable indicator”) before it may use the *allocation key*.

278. The detailed expectation of the reasonable steps varies for each category of Adjusted Revenues, so that it is proportionate to the nature of the Adjusted Revenues and business model in question. In general terms, to satisfy the reasonable steps requirement, the Covered Group is expected to use information that is available to it and that can feasibly be used to source Adjusted Revenues in accordance with the applicable rule. In some cases, it is expected that the management team responsible for the relevant business is consulted to understand whether information is available and in other cases a degree of manual contract review of the Covered Group’s customer contracts is required to confirm whether or not information is available. In applying a reasonableness standard, the level of expectation of what is required reflects the context and balance of risks and rewards, depending on the category of Adjusted Revenues and in some cases the value of the customer contract. For example, it is acknowledged that obtaining reliable information on the source of Adjusted Revenues from components, certain other services and certain *intangible property* will be difficult, because of the commercial operation of those businesses and the lack of contractual or transactional proximity to the market Jurisdiction. This Explanatory Statement provides further examples of the expectations of reasonable steps in the context of each category of Adjusted Revenues for which an *allocation key* is provided, and which are intended to reflect the commercial reality and not impose disproportionate burdens or create commercial disruption and competitiveness issues. In all cases, the Covered Group is required to actively consider the available information and whether it can meet the definition of a *reliable indicator*.

279. Given that the revenue sourcing rules are intended to rely on commercial and other available information rather than to create new reporting obligations, in all cases, the meaning of reasonable steps does not include an obligation to change new or existing contractual arrangements, nor to make a request to a contractual counterparty to do so. If a Covered Group does change its contractual arrangements, it may yield information that could be a *reliable indicator*, but would be beyond the reasonable steps

requirements. In other words, the fact that a Covered Group has not pursued a change in contractual arrangements should not prevent it from being able to use the relevant *allocation key* as a *reliable method*, provided the other conditions are met.

280. Similarly, where this Explanatory Statement provides specific guidance on the extent of the reasonable steps requirement, a Covered Group is not required to exceed those expectations in order to use the relevant *allocation key* as a *reliable method*. However, this does not preclude the Covered Group from taking additional steps to identify *reliable indicators* should it choose to go beyond the requirement of reasonable steps. For example, in the context of other services and certain categories of *intangible property*, the reasonable steps requirement balances the need for accuracy against the compliance burden by limiting the reasonable steps obligation to efforts undertaken only in respect of the largest customers; however, a Covered Group could also apply those efforts to more, or all, of its customer base instead of using the *allocation key*. However, there can be no negative inference in respect of a Covered Group that applied the reasonable steps requirement but chose not to go beyond that requirement.

281. Third, subdivision (iii)(C) provides that certain Jurisdictions must be removed from the application of the *allocation key*. This is known as the “knock-out rule”. The condition set out in subdivision (iii)(C) is that the Covered Group has an obligation to remove the Jurisdiction(s) (if any), on the basis of legal, regulatory or documented structural commercial considerations, in which no Adjusted Revenues could reasonably be expected to arise. The purpose of the knock-out rule is to refine the application of the *allocation key* to take account of information the Covered Group has (even if that information would not meet the definition of a *reliable indicator* that could be used to positively identify the source Jurisdictions). The reference to legal, regulatory or other documented structural commercial considerations is intended to provide an objective way that the Covered Group can demonstrate, at a structural level rather than a transactional level and based on category level rather than for individual products, that a Jurisdiction is highly unlikely to be a final market Jurisdiction. This should ensure that Covered Groups apply the knock-out rule in a way that is consistent across business models, and which tax administrations can verify.

282. The presence of relevant legal or regulatory considerations should be able to be objectively demonstrated, for example, by reference to the relevant legislation. A documented structural commercial consideration is likewise intended to be something that is readily identifiable and of a structural nature, such as a documented management decision not to be present in a certain market, or the presence of conditions for entry to a market that, although not legally impeding access, are of such a high bar or pose a serious commercial risk that can be evidenced, such as a requirement for a majority of employees to be local staff in a context where that could not be feasible for the business in question, where there are significant state subsidies provided to local competitors that mean it is not viable to access that market, or risk of natural disaster that would seriously affect the business in question. As the commercial consideration must be of similar nature to a legal or regulatory considerations and be structural in nature, it does not refer to transactional information where a certain product in a particular situation was not sold in a given Jurisdiction.

283. The knock-out rule applies where the Covered Group has information that the good, product or service is not provided to certain Jurisdictions, such as where there is no legal authorisation to do so or where there is a documented structural commercial impediment to doing so. The knock-out rule is provided so that where there is reliable information about the locations where a good, product or service is ultimately used (even if this cannot be allocated in specific proportions), Adjusted Revenues would be only sourced to those Jurisdictions.

284. This Explanatory Statement provides examples of the knock-out rule in the context of different categories of Adjusted Revenues. In certain categories, such as components, certain other services and certain *intangible property*, it is recognised that because the Covered Group is already at the stage of

applying the *allocation key*, it may not have any information to apply the knock-out rule. In such cases, a Covered Group should not be precluded from using the *allocation key* as a *reliable method*.

285. The application of the knock-out rule is already incorporated into the *regional allocation key*, where applicable. In order to apply the *regional allocation key*, the Covered Group must identify the Jurisdictions where Adjusted Revenues arise to define the region in respect of which the *allocation key* should be applied. As such, the Covered Group has already positively identified the Jurisdictions where Adjusted Revenues arise and the knock-out rule has no further role to play; and accordingly, the requirement to apply subdivision (iii)(C) is treated as automatically satisfied.

Subdivision (iv)

286. Subdivision (iv) of the definition of *reliable method* provides that in the case of transport services, the *allocation key* provided in the relevant part of Annex D shall be considered a *reliable method*. This reflects the fact that the rule for transport services is designed differently than the other categories, in making the *allocation key* available as a primary method for sourcing. This means that in the case of transport services, the conditions in subdivision (iii) are not applicable.

Reliable indicator

287. *Reliable indicators* form a core part of the *reliable method*. Paragraph 3(b) provides that the term *reliable indicator* means information (other than an *allocation key*) that identifies the source of Adjusted Revenues consistently with the revenue sourcing principle identified in Article 7 with respect to the category of Adjusted Revenues at issue. There are different types of indicators, but they must all meet this core requirement.

288. This core requirement includes that in order for an indicator to be reliable, it is not simply information; but it is information that serves the purpose of identifying the source Jurisdiction as identified for each category of Adjusted Revenues in Article 7. For example, a phone number is information, but it is only an indicator to the extent that the location of a customer can be derived from it (i.e. from the country code) as the basis for identifying the source Jurisdiction.

289. The core requirement further provides that the indicator must produce results that are consistent with the revenue sourcing principle for the category of Adjusted Revenues at issue. The phrase “consistent with” means that it must give effect to the sourcing rule; for example, an indicator would not be consistent with the sourcing rule, and therefore would not be reliable, in the case of online advertising if it leads to the Jurisdiction of the customer paying for the advertising as opposed to the viewer of the advertisement. This requirement also means that even where the Covered Group has one of the indicators provided in the relevant sourcing rule available to it, this indicator cannot be used if the Covered Group knows that the indicator would not provide a result that is consistent with the sourcing rule. For example, even though the billing address is listed as an enumerated indicator in Annex D for revenue sourcing of other services to smaller customers, if the Covered Group knows that this would give an inconsistent outcome because the billing address is that of its customer’s procurement or shell entity (indicated, for example, by the fact that it has very low or no substance, has very few employees actually using the service in that location, is in a low tax jurisdiction and most of its customer’s operations are located in another Jurisdiction), then that indicator cannot qualify as reliable. In other words, the enumerated indicators provided for in Annex D are not presumptively valid, but they must additionally meet this test of being reliable.

290. At the same time, the phrase “consistent with” in paragraph 3(b) does not require that the sourcing result is infallible in every case. Rather, it means that the result is credible and logical in context, and produced by systems that meet the requirements for an *internal control framework* included in the rules on Administration. Having a realistic expectation of this threshold is necessary because it is recognised that

if the threshold for a *reliable indicator* is set too high, it would ultimately force the reliance on *allocation keys* even in scenarios where good (but not perfect) information was available. In this respect, it is noted that when a Covered Group uses information from third parties as indicators, e.g. information received from an independent distributor to source Adjusted Revenues from the sale of finished goods sold through an independent distributor information from a reseller of services, or information from a licensee of *intangible property*, the Covered Group cannot be expected to account for the possibility that the information is incorrect due to a breach of contract by that independent distributor or the occurrence of other illicit trade outside the control of the Covered Group. In cases where the Covered Group has actual knowledge that third party information is incorrect, it cannot be regarded as consistently with the sourcing rule.

291. Beyond this core requirement in the definition of *reliable indicator*, there are two ways that information could be demonstrated to be a *reliable indicator*, set out in subdivisions (i) and (ii).

292. Either approach is equally valid, provided the tests for reliability are met. This means that the revenue sourcing rules are not prescriptive as to which indicator must be used, and do not mandate any hierarchy amongst the enumerated *reliable indicators* themselves or as against another *reliable indicator* or an alternative *reliable indicator*, in order to provide flexibility for different facts and circumstances. The tests for reliability do not require that the choice of indicator itself needs to be consistently used year on year. That is both with respect to whether the Covered Group applies an enumerated *reliable indicator*, another *reliable indicator*, or an alternative *reliable indicator*, as well as whether the Covered Group uses different enumerated *reliable indicators* in a different Period. For example, where technology, commercial practice or business models evolve, then it may be appropriate or even necessary that the approach to using indicators also evolves. However, such a change would be expected to be explained in the documentation package.

293. Furthermore, the use of another *reliable indicator* and an alternative *reliable indicator* is not mandatory. In other words, when the Covered Group can use the enumerated *reliable indicators*, it is not obligated to devise and test an alternative approach. At the same time, if the Covered Group cannot access enumerated *reliable indicators* (having taken reasonable steps to try to do so), it is permitted to use the relevant *allocation key*. In such cases, it is not required to consider and document whether there are alternative approaches available in the form of another *reliable indicator* or an alternative *reliable indicator*. Rather, it is available for those Covered Groups that choose to, and can, demonstrate that the alternative approach is otherwise reliable. This is also noted in the requirement in the definition of *reliable method* in paragraph 3(a)(iii)(B), which notes that the pre-condition of taking reasonable steps to obtain *reliable indicators* before accessing an *allocation key* is limited to seeking enumerated *reliable indicators*.

Subdivision (i)

294. Subdivision (i) sets out three alternative tests for reliability. A Covered Group must meet one or more of these tests in order for the indicators to be reliable. This test could be met by the indicators expressly listed in Annex D (“enumerated reliable indicators”) or other *reliable indicators* that meet the same test of reliability but are not expressly listed in Annex D (“another reliable indicator”).

295. First, subdivision (i)(A) provides that indicators can be reliable if they are relied upon by the Covered Group for commercial purposes or to fulfil legal, regulatory, or other related obligations. This information provides assurance about the quality of the information because the Covered Group is relying on the information for other purposes. This means it takes on the risk associated with poor information, as poor information would expose the Covered Group to commercial, legal or regulatory risk. In other words, the Covered Group has an interest in ensuring this information is credible because it relies on it to operate its business and make it a commercial success, or because it relies on it to comply with other obligations

(and compliance with those obligations may well be subject to scrutiny). The reference to “commercial purposes” includes that the information could be for an internal, non-tax related purpose, even if not subsequently reported externally by the Covered Group, such as internal research and reporting to management on the operational results of the business or information held in internal management systems used to operate the business. It can also include information provided by a customer, distributor or another intermediary. The reference to legal, regulatory or other related obligations includes information prepared for audited and statutory accounts; for stock market disclosures; for compliance with consumer protection or safety regulations. It can also include information prepared for tax purposes, such as corporate tax, VAT or customs requirements. While this is a wide range of information, as noted above, it may only be used if the core requirement in the definition of *reliable indicator* is met. That means, for example, that if information used for corporate tax, VAT or customs did not correspond to the sourcing rule for the category of Adjusted Revenues at issue (for example, often where sales are recorded for corporate tax purposes will not reflect the market for the purpose of revenue sourcing or if components are exported to a third party, the related customs data would not identify the location of the final customer of the finished good), then the fact that it was used for commercial purposes will not cure that issue and the information cannot be used for revenue sourcing. On the other hand, data used to identify the place of supply of business to consumer digitally supplied services for VAT purposes are generally intended to identify the location of the consumer. As that coincides with the place of use of such digital content or services, that data would be regarded as consistent with the sourcing rule.

296. Subdivision (i)(B) provides that indicators can be reliable where the consistency of the information is demonstrated by virtue of being verified by third party information. This applies where the indicator is confirmed by a third party, and which has its own commercial, legal, regulatory or other similar reason for having the information. This means that the Covered Group has information that demonstrate the source Jurisdiction; and in respect of which the same source Jurisdictions are in turn confirmed by other information of that third party. An example of this is a commercially available database monitoring the sales of prescription drugs, which has been prepared by the third party database owner in furtherance of its own business, or in furtherance of its own legal or regulatory obligations, and which the Covered Group uses to verify the correctness of its own indicators.

297. Subdivision (i)(C) provides that indicators can be reliable where the consistency of the information is demonstrated by “double confirmation” with an enumerated indicator. This test means that provided that at least one of those indicators is an enumerated indicator from the relevant sourcing rule, then the other indicator will be reliable if it also provides the same sourcing result as the enumerated indicator. For example, if the operator of an online intermediation platform collected a range of information relating to users who purchased goods on the platform and confirmed that the Jurisdiction of the delivery address matched the Jurisdiction of the user’s IP address, that would amount to a double confirmation and the indicators would be reliable. For other users the Jurisdiction of the delivery address might be different to the Jurisdiction of the IP address and in those cases, the Covered Group would need to find an alternative method to confirm the reliability of the indicator. This could include identifying a third indicator (e.g., user profile information) which confirms either the billing address or the IP address.

Subdivision (ii)

298. Subdivision (ii) provides an alternative basis for showing that information meets the definition of being a *reliable indicator*, where the Covered Group cannot meet one of the specific reliability tests in subdivision (i). These are referred to as “alternative reliable indicators”, which meet a different test of reliability, and are also not expressly listed in Annex D. For example, the information that can be used in this regard would not only include information that is relied upon for other commercial purposes or to fulfil legal, regulatory, or other related obligations or third-party information, but also other data generated by the Covered Group, information such as market research and publicly available information. It means that

it could permit the reliance on information that is prepared specifically for purposes of the Convention, as opposed to being relied upon for unrelated purposes or obligations. It could also be or be a combination of types of information and could be information that enables the Covered Group to develop its own proxy.

299. However, even though it does not meet these same reliability tests, the ability to use an alternative *reliable indicator* is still subject to equivalent safeguards as to reliability (in addition to the requirement to meet the core requirement in the definition, as above).

300. The first is that the Covered Group provides documentation to the *review panel* or *determination panel* in an *advance certainty review* pursuant to Article 23 demonstrating that the indicator is reliable and explaining why it was used in place of an indicator enumerated in Annex D.

301. Information will be regarded as being otherwise reliable for purposes of this provision if the information is of good quality in terms of its source, coverage, consistency and commercial credibility. When demonstrating that the information is otherwise reliable, the Covered Group would be expected to establish that the information:

- is logically relevant to determining where the Adjusted Revenues arise – in this respect the Covered Group would need to explain why the information it seeks to rely on can be expected to identify the market Jurisdictions;
- is sufficiently broad in its geographical coverage – in this respect the data set relied on by the Covered Group would usually be expected to be global in its coverage. If it is not a global data set, the Covered Group would be expected to explain why a more limited data set can produce credible sourcing results, or to show how alternative information is used to reliably approximate the results to provide global coverage (such as completing the data set based on a correlation with macroeconomic indicators);
- has been collated using accurate and appropriate data collection techniques – in this respect, the Covered Group should be able to demonstrate that the data on which it seeks to rely was accurately, consistently and appropriately collected. This would typically require an explanation of how the data was selected for collection and why any data in particular might have been excluded from the collection process. If the data relied on was collated by a third party, the Covered Group should outline the methodology applied by that third party. If the data was published by an international institution such as UNCTAD or the IMF, it should be assumed that the data was collected using accurate and appropriate collection techniques.
- where the use of the information upon which the Covered Group seeks to rely is based on assumptions, it would be important to establish that those assumptions are justifiable in the light of the commercial context such that they are credible assumptions and are capable of being tested by the Covered Group (see examples at paragraphs 2228 and 2268).

302. The Covered Group must also provide documentation to the *review panel* or *determination panel* in the *advance certainty review* explaining the reasons for using that information to identify where the Adjusted Revenues arise, instead of an enumerated *reliable indicator*. This does not mean that there is a hierarchy of indicators. However, this requirement provides the panel with additional insight into the approach taken by the Covered Group, and ensures that the Covered Group is carefully considering how to conduct its revenue sourcing more generally.

303. The second requirement in clause B is that the use of the proposed alternative *reliable indicator* is agreed in an *advance certainty outcome*. This means that the Covered Group will not be able to use this

alternative *reliable indicator* without participating in the Advance Certainty Process. The rules on administration provide for a transition period to accommodate the application of these rules in the Period before the Advance Certainty Process has provided a *certainty outcome*. The details for applying the transition period are set out in Annex E Section 1 of the rules on Administration.

304. Finally, in Articles 6 and 7 the term *reliable indicator*, is used in a singular form. However, there may be situations where the Covered Group uses more than one indicator to source (part of) its Adjusted Revenues. The Covered Group is not restricted to using only one indicator, but may use (a combination of) several indicators. For example, a Covered Group providing online advertising services may use an algorithm which combines multiple data points such as IP address and geolocation and other user information, to arrive at an identification of where the viewer was located (subject to any applicable laws such as privacy laws).

Allocation key

305. An *allocation key* is defined in paragraph 3(c) as a method identified in Annex D for determining source of Adjusted Revenues derived from a category of *transactions* without reference to *reliable indicators*. It is a formulaic proxy for revenue sourcing, generally based on macroeconomic data. An *allocation key* applies in the absence of *reliable indicators*, and is provided for in Article 6 and Annex D in those cases where it is envisaged (based on commercial considerations known to be prevalent in that category) that the Covered Group is unlikely to have *reliable indicators* to source its Adjusted Revenues to the relevant Jurisdictions and provided other conditions are met, the use of that *allocation key* can be a *reliable method*. An *allocation key* is also provided where the Covered Group is found by the Tax Certainty Panel (or by tax administrations if the tax certainty process is not applicable) to have failed to identify or correctly apply a *reliable indicator*. This is referred to as a default *allocation key*, discussed under paragraph 4, and is not a *reliable method*.

306. There are specific *allocation keys* that apply to different categories of Adjusted Revenues. These are set out within each category in Annex D, and defined in Annex D.

Paragraph 4

307. Paragraph 4 provides a backstop rule to source Adjusted Revenues, using a default *allocation key*. Article 6(2) requires the application of the *reliable method* and all Covered Groups are required to use a *reliable method*. However, this paragraph 4 applies to ensure that all revenue can be sourced, as a last resort, in the event that a *reliable method* was not applied by the Covered Group or required to be applied by a certainty panel (or a tax administration if the Covered Group has not elected into the certainty process). This could be the case where a Covered Group has tried to apply the rules but fails (e.g. the *review panel* or the *determination panel* found that it did not use indicators that met the definition of *reliable indicator*) and the Covered Group does not have the information to be able to apply an alternative that the panel would consider to be a *reliable method*, or for a particular Period does not have the information to be able to apply the rules, or refused to properly apply the rules.

308. In such cases, the difficulty would then arise that by the time that the *review panel* or the *determination panel* (or individual tax administrations, if the certainty process is not applicable) reviews the filing, the underlying information to correctly complete the revenue sourcing for the Period may no longer be available, or in the case of a non-compliant Covered Group, may not be available to tax administrations. The default rule in paragraph 4 provides a mechanism by which tax administrations can proceed with an assessment in the absence of the correct underlying data from the Covered Group needed to complete the revenue sourcing in accordance with the rules.

309. A default *allocation key* is provided for all cases, including those where it is expected that the Covered Group would typically be able to collect the information required to complete its revenue sourcing (such as for finished goods sold to final customers directly; *location-specific services*; *immovable property*; and government grants) as it is accepted that in all cases a backstop rule is required to ensure all Adjusted Revenues can be sourced. It ensures that, even in the absence of information or in the event that a Covered Group has not fulfilled its obligations, tax administrations are able to make a default revenue sourcing assessment for the Convention.

310. The default *allocation key* is in almost all cases the *global allocation key* (as set out in paragraph 4(c)), which is based on a macroeconomic proxy using *final consumption expenditure*. However, a different *allocation key* applies in two cases. Paragraph 4(a) sets out that the default *allocation key* for components is the *component allocation key*, which is based on a macroeconomic proxy using GDP. Paragraph 4(b) sets out that the default *allocation key* for services referred to in Article 7(1)(d)(ix) (other services) is the *service allocation key*, which is also based on a macroeconomic proxy using GDP. In some cases (including for components and other services sold through resellers), the default *allocation key* is the same as the *allocation key* that can be applied as a *reliable method*. Where the *allocation key* used is the default *allocation key* (without meeting the requirements of a *reliable method* before using the *allocation key*, such as reasonable steps and the knock-out rule), the Covered Group will not be treated as having applied a *reliable method* to those Adjusted Revenues.

Article 7 – Sourcing principles for categories of Adjusted Revenues

311. Article 7 sets out the sourcing principle for the purpose of identifying a *reliable method* to determine the Jurisdictions in which the Adjusted Revenues of a Covered Group shall be treated as arising. It sets out the relevant principle separately for each of the categories of Adjusted Revenues: finished goods; digital content; components; services; *intangible property* and user data; *immovable property*; government grants; and non-customer revenues. Where further detail on the meaning of each category is relevant, the Explanatory Statement as it relates to Annex D below provides further discussion.

Paragraph 1

312. **Paragraph 1(a)** sets out the sourcing principle for finished goods. Adjusted Revenues from finished goods are sourced to the Jurisdiction in which the finished goods are delivered to the final customer.

313. **Paragraph 1(b)** sets out the sourcing principle for the provision of digital content. This includes items such as software, which are sourced to the place of use of the digital content. The approach taken to sourcing based on the place of use is the same as that taken for other services (Article 7(1)(d)(ix)) unless the digital content is a component (referred to in Article 7(1)(c)), in which case the rule for components is applied. This rule links to the services rule in Article 7(1)(d)(ix) for convenience only (given that the sourcing rule and indicators would have been the same, as the rules in Article 7(1)(d)(ix) also source to the place of use) without prejudice to any characterisation issue as to whether such products (e.g. software) are a service or a sale or other form of *transaction* for domestic law purposes. This approach ensures that Adjusted Revenues from all sales of digital content are treated in the same way for purposes of the revenue sourcing rules, regardless of the legal nature of the *transaction* (i.e., sale of a good or a service or something else).

314. **Paragraph 1(c)** sets out the sourcing principle for components, which are sold to a business customer and designed to be incorporated directly or indirectly into a finished good that will be sold.

Adjusted Revenues from components are sourced to the Jurisdiction of final consumption of the finished goods into which the component is incorporated, which is where the finished goods containing the component are delivered to the final customer. This means that components are sourced to their ultimate destination and not to an intermediate Jurisdiction in the supply chain.

315. **Paragraph 1(d)** sets out the sourcing principle for services. There are nine different types of services, each with their own specific rule reflecting the nature of that service.

316. Paragraph 1(d)(i) sets out the sourcing principle for *location-specific services*, being those performed in respect of tangible property or at the physical location of the customer. The rule is split into two parts. Adjusted Revenues from services connected to tangible property are sourced to the Jurisdiction in which the property is located under paragraph 1(d)(i)(A), given the necessary proximity of the performance to the tangible property. Services performed in the presence of the customer (or its agent) are sourced to the Jurisdiction where the customer (or its agent) is situated when the service is performed under paragraph 1(d)(i)(B), given the necessary proximity of the place of performance to the customer. The rule relating to services performed in the presence of the customer refers to where the customer is situated at the time of performance and not to the location of the customer. Where the customer is situated is intended to refer to where the customer is at the specific point in time when the service is performed. The location of the customer is used throughout the document to refer to the customer's habitual location as discussed in paragraph 2253.

317. The source rule expressly provides that it does not apply to passenger transport services. This language is required to deal with a potential overlap between services performed in the presence of the customer and passenger transport services. Given the passenger generally must be present where the transport service is performed, a priority rule was required to ensure that the rules in Paragraph 1(d)(vi) apply to passenger transport services. Similarly, the rule expressly provides that it does not apply to Adjusted Revenues that could also be treated as being derived from *immovable property*. For example, the lease of a building falls within the definition of location specific service, however, it would also be covered as Adjusted Revenues from *immovable property*. The priority rule ensures that in such cases, the sourcing rule for *immovable property* in paragraph 1(g) applies.

318. Paragraph 1(d)(ii) sets out the sourcing principle for online advertising services. Such Adjusted Revenues are sourced to the Jurisdiction in which the viewer of the advertisement is located.

319. Paragraph 1(d)(iii) sets out the sourcing principle for non-online advertising services (such as billboards or magazines). Such Adjusted Revenues are sourced to the Jurisdiction in which the advertisement is displayed or received.

320. Paragraph 1(d)(iv) sets out the sourcing principle for online intermediation services that facilitate the sale or purchase of tangible goods, digital content or services other than *location-specific services*. The Adjusted Revenues are sourced to two Jurisdictions, in equal proportions. 50 per cent is sourced to the Jurisdiction in which the purchaser of tangible goods, digital content or services other than *location-specific services* is located. The other 50 per cent is sourced to the Jurisdiction in which the seller of the tangible goods, digital content or service other than a *location-specific service* is located.

321. Paragraph 1(d)(v) sets out the sourcing principle for online intermediation services that facilitate the sale or purchase of *location-specific services*. The Adjusted Revenues are sourced to two Jurisdictions, in equal proportions. 50 per cent is sourced to the Jurisdiction in which the purchaser of the *location specific service* is located. The other 50 per cent is sourced to the Jurisdiction in which the *location-specific service* is performed.

322. Paragraph 1(d)(vi) sets out the sourcing principle for passenger transport services. The rules are broken down into air transport and non-air transport. However, the principle is generally the same, which is to source the Adjusted Revenues to the destination. In both cases, this sourcing rule also applies to *transactions* other than customer reward programs that are ancillary to the transport services provided by the Covered Group. The main difference is that in the case of non-air transportation, certain transit stops are disregarded as a destination.

323. Paragraph 1(d)(vii) sets out the sourcing principle for cargo transport services. cargo transport services means both (i) services for carrying cargo from one location to another; and (ii) connected supplementary services. The rules are broken down into air transport and non-air transport. However, the principle is generally the same, which is to source the Adjusted Revenues 50 per cent to the Jurisdiction in which the cargo is loaded, and 50 per cent to the Jurisdiction in which the cargo is unloaded. In both cases, this sourcing rule also applies to ancillary services. The main difference is that in the case of non-air transportation, certain transit stops are disregarded as a place of uploading and unloading, whereas for air transportation, each place of unloading is regarded as a place of destination. As such, the place of origin and place of destination that Adjusted Revenues from non-air transport services are sourced to are the places the Covered Group is engaged to deliver the cargo from and to even if the Covered Group engaged another party to undertake some or all of the transport service. This is facilitated by the inclusion of the phrase “*provided by or on behalf of the Covered Group*” in paragraph 1(d)(vii)(B) and which is not included in paragraph 1(d)(vii)(A). In addition, the rule specifies that for transport involving both air and non-air transport services that are not separately itemised, the rule for cargo transport services provided other than by air transport applies.

324. Paragraph 1(d)(viii) sets out the sourcing principle for customer reward programs. These refer to Adjusted Revenues from operating such a program other than Adjusted Revenues generated from the redemption of awarded units for goods or services provided by the Covered Group. Such Adjusted Revenues are sourced to each Jurisdiction in proportion to the number of members located in each Jurisdiction that have redeemed or earned one or more units during the Period.

325. Paragraph 1(d)(ix) sets out the sourcing principle for other services. This refers to any service not referred to in the preceding parts of paragraph (d), and would include provision of financing, business-to-consumer (B2C) services, as well as business-to-business (B2B) services such as cloud computing and consulting services. Such Adjusted Revenues are sourced to the Jurisdiction in which the service is used.

326. **Paragraph 1(e)** sets out the sourcing principle for *intangible property*. Adjusted Revenues from *intangible property* (whether by way of licensing, sale or any other form of alienation) are sourced according to the nature of the use of the *intangible property*.

327. Paragraph 1(e)(i) sets out the sourcing principle for *intangible property* that relates to finished goods or components (such as a trademark on clothing). Such Adjusted Revenues are sourced to the Jurisdiction where the finished goods are delivered to the final customer (and in the case of *intangible property* that relates to a component, the Jurisdiction where the finished goods containing the component are delivered to the final customer).

328. Paragraph 1(e)(ii) sets out the sourcing principle for *intangible property* that is attached to digital content (such as a song on a streaming platform) or supports a service (such as a franchised restaurant). Such Adjusted Revenues are sourced to the Jurisdiction in which the digital content or service is used.

329. Paragraph 1(e)(iii) sets out the sourcing principle for *intangible property* that is not covered under these aforementioned categories, for example, uncommercialised *intangible property*. Such Adjusted Revenues are sourced to the Jurisdiction in which that *intangible property* is used.

330. **Paragraph 1(f)** sets out the sourcing principle for user data. Such Adjusted Revenues are sourced to the Jurisdiction in which the user associated with the data is located.

331. **Paragraph 1(g)** sets out the sourcing principle for *immovable property*. Adjusted Revenues from *immovable property* are sourced to the Jurisdiction where the *immovable property* is located.

332. **Paragraph 1(h)** sets out the sourcing principle for grants, subsidies and refundable credits made or funded by governments or *international organisations* (“government grants”). To the extent that government grants are included in the Covered Group’s Adjusted Revenues (as determined by the relevant accounting standard), and not as a negative expense in the income statement, they are also sourced for the Convention.

333. Government grant means cash or in-kind transfers made by a government or *international organisation* (which is in turn funded by governments) and includes payments to finance business expenses, costs of acquiring fixed assets, subsidies, grants and refundable credits. The term government includes a government, a political subdivision or local authority thereof, the central bank of the Jurisdiction or any institution wholly owned by that Jurisdiction or a political subdivision or local authority thereof.

334. Adjusted Revenues from government grants are sourced to each Jurisdiction(s) that funded the grant in proportion to the funding provided. If more than one government made or funded the grant (for example, in the case of funding provided in the European Union or through an *international organisation*), then the Adjusted Revenues are allocated in proportion to the percentage share of the funding provided by each Jurisdiction.

335. However, if the Covered Group does not have such information available (for example as part of the terms of the grant), then the Adjusted Revenues are deemed to arise equally in each Jurisdiction that funded the grant, or where that information is unavailable, equally in each Jurisdiction that is a member of the *international organisation* that funded the grant. The Covered Group is not required to research the funding arrangements of the *international organisation* to try to identify the proportion contributions.

Paragraph 2

336. Paragraph 2 sets out the sourcing principle for Adjusted Revenues that are not derived from third-party customers of the Covered Group and are not otherwise covered by the preceding paragraphs (“non-customer revenues”).

337. This rule for non-customer revenues recognises that some items may be reported as Adjusted Revenues, but are not generated in a *transaction* performed with a customer. These Adjusted Revenues are of a more generic nature; they are not a specific line of business with a particular connection to a market Jurisdiction, but relate to the Covered Group as a whole. This includes interest earned by the Covered Group other than as a lender, returns on *financial assets*, foreign currency gains, releases of provisions, changes in pension liabilities, insurance proceeds and other non-operating income; and returns from and gains on the disposition of assets.

338. Paragraph 2 provides the sourcing rule for non-customer revenues. These are sourced to each Jurisdiction in proportion to the other Adjusted Revenues treated as arising in those Jurisdictions under the preceding rules.

Article 8 – Nexus

339. Article 8 contains the special purpose nexus rule which determines whether the nexus test is satisfied in a market Jurisdiction for a Period. The thresholds ensure that the nexus test is only satisfied when the amount of Adjusted Revenues of a Covered Group treated as arising in a market Jurisdiction is material.

340. The amount of Adjusted Revenues of a Covered Group that are treated as arising in a Jurisdiction (if any) is determined pursuant to the revenue sourcing rules, in Articles 6 and 7 and Annex D. The application of the nexus test is based on the Adjusted Revenues earned by the Covered Group, without needing to identify a specific Entity that is deriving those Adjusted Revenues.

341. The nexus test is applied for each Period. When a Covered Group satisfies the nexus test in a market Jurisdiction, that Jurisdiction is eligible for the allocation of the relevant portion of the Amount A Profit of a Covered Group for that Period (if any) determined pursuant to Article 5.

342. The general rule contained in subparagraph (a) is that the nexus threshold is set at an amount equal or greater than EUR 1 million in Adjusted Revenues treated as arising in a Jurisdiction.

343. An alternative nexus threshold is set in subparagraph (b), for Jurisdictions with an annual Gross Domestic Product (GDP) of less than EUR 40 billion. For those Jurisdictions, the nexus threshold will be EUR 250 000 instead of EUR 1 million.

344. Where the Period is shorter or longer than twelve months (or 365 days), Article 3(10) provides that the monetary threshold of EUR 1 million (or EUR 250 000, where applicable under subparagraph (b)) is adjusted proportionally to correspond with the length of the Period by reference to the ratio of the number of days in the Period to a reference period of 365 days. In the absence of such a rule a Covered Group may inappropriately meet the nexus test if the Ultimate Parent Entity prepares Consolidated Financial Statements for a Period longer than twelve months (or 365 days), meaning higher absolute Adjusted Revenues for that Period. Conversely, a Covered Group may inappropriately fail the nexus test if the UPE prepares Consolidated Financial Statements for a Period shorter than twelve months (or 365 days), meaning lower absolute Adjusted Revenues for that Period (see the illustration in Box 4 at paragraph 184).

345. GDP is defined in Article 2(v) to mean the gross domestic product value for the most recent calendar year that does not end after the Period ends, expressed at current United States dollars as published by the United Nations for a Jurisdiction and converted to euro based on the average foreign exchange rate for the month of December determined by the foreign exchange reference rates as quoted by the European Central Bank. Conversion to euro is necessary to test it against the nexus threshold, which is also expressed in euro. If the United Nations has not published the relevant data for any of the past five years, GDP is determined by reference to data published by the World Bank and, if the World Bank data is also not available for any of the past five years, an approximation is calculated.

Box 13. Examples – definition of GDP

The following examples illustrate the application of the definition of GDP.

Example 1

Jurisdiction A's gross domestic product value for 2024 and 2025 are published by both the United Nations and the World Bank. In addition, the World Bank also published the value for 2026. The relevant Period is the calendar year 2027. The value for 2025 (as it is more recent than 2024) published by the United Nations would be used and converted to EUR at the Average Exchange Rate for purposes of the definition of GDP. The more recent value for 2026 published by the World Bank is not used, because data published by the United Nations is available for that Jurisdiction and does not relate to a calendar year that predates the Period by more than five years.

Example 2

Jurisdiction A's gross domestic product values for 2024 and 2025 are published by both the United Nations and the World Bank. In addition, the World Bank also published the values for each of the years following 2025. The relevant Period is the calendar year 2031. The value for 2025 published by the United Nations predates the Period by more than five years and so cannot be used. Instead, the most recent value published by the World Bank is used.

Example 3

Jurisdiction B's gross domestic product value is not published by the United Nations for any year but the value for 2024 is published by the World Bank. This means that, for Period 2025, the value for 2024 published by the World Bank is used.

Example 4

Jurisdiction C's gross domestic product value is not published by the United Nations or the World Bank for any year. The population of Jurisdiction C for 2025 published by the Population Division of the Department of Economic and Social Affairs of the United Nations is 1 million. Assume that for 2025 the simple average of the ratio of GDP to population for all Jurisdictions for which GDP is available was EUR 20,000. In this case, Jurisdiction C's GDP for purposes of the Convention for Period 2025 is considered to equal EUR 20 billion, which is calculated using the formula: 1 million x EUR 20,000.

346. The new special purpose nexus rule applies solely to determine whether a market Jurisdiction qualifies for profit re-allocation under the Convention. As such, it will not alter the nexus for any other tax purpose (including any income tax purpose other than Amount A) or for any other non-tax purpose.

347. In other words, the fact that a Covered Group satisfied the nexus test for a Period in a Jurisdiction cannot itself result in any Group Entity of that Covered Group being treated as having a presence that makes it liable for other tax or non-tax liabilities. As such, it cannot be the basis for a re-assessment of a Covered Group Entity's tax position under existing tax rules.

348. For example, a Covered Group Entity cannot be deemed to have a permanent establishment in a market Jurisdiction solely because the Covered Group to which the Entity belongs has satisfied the nexus test in that Jurisdiction. The treatment under the Convention is irrelevant for purposes of the interpretation

and application of the definition of permanent establishment in any bilateral or multilateral tax treaties, or domestic legislation.

349. Similarly, where a Covered Group Entity does have a permanent establishment under the relevant tax rules, the amount of profit attributed to that permanent establishment in a Jurisdiction under existing profit allocation rules (e.g. under bilateral tax treaties) cannot be re-assessed because the Covered Group to which the Entity belongs has satisfied the nexus test in that Jurisdiction. Neither can the administrative obligations that apply to that Group Entity relating to existing tax rules be expanded. Further, the failure of a Covered Group to meet the nexus threshold in a Jurisdiction has no bearing on whether that Jurisdiction can be required to provide relief from double taxation under Part IV.

Part IV – Elimination of double taxation

Article 9 – Relief for Amount A taxation

350. Article 9 provides the mechanism through which double taxation is eliminated under Part IV. It first requires the identification of each *specified jurisdiction* with respect to a Covered Group for a Period. *Specified jurisdictions* are identified under Article 10. The next step is to identify those *specified jurisdictions* that are *relieving jurisdictions*. A *relieving jurisdiction* is identified in accordance with Article 11(3) and is a *specified jurisdiction* that is allocated the obligation to eliminate double taxation under Article 11(6) through (15).

351. Finally, among *relieving jurisdictions*, only Parties to the Convention are required to eliminate double taxation. To avoid a situation in which Parties bear the share of relief that would otherwise belong to non-participating jurisdictions, Article 11 apportions the obligation to eliminate double taxation among *relieving jurisdictions* irrespective of whether they are Parties. Article 9, however, provides that only those *relieving jurisdictions* that are Parties will have to provide relief under the conditions described in Articles 12 and 13. Article 9 requires that a Party that is a *relieving jurisdiction* provides relief from Amount A taxation to the Group Entities identified in accordance with Article 13. The Group Entities entitled to relief from double taxation are the *relief entities* for a Covered Group. Article 12 describes the methods a Party may use to provide relief from double taxation to those *relief entities*.

Article 10 – Identification of the specified jurisdictions for a Covered Group

352. With respect to a Covered Group for a Period the obligation to eliminate double taxation with respect to Amount A relief can only be attributed to a Jurisdiction that meets the definition of a *specified jurisdiction*. Article 10 contains the definition of the term *specified jurisdiction*. This definition effectively operates as a de minimis threshold and it is Article 11 that allocates the obligation to eliminate double taxation with respect to *Amount A relief amounts* among *specified jurisdictions*.

353. A Jurisdiction will be a *specified jurisdiction* with respect to a Covered Group for a Period if it satisfies any one of three limbs to this definition. The first limb includes each Jurisdiction that is part of the smallest number of Jurisdictions with respect to which the sum of *elimination profit (or loss)* (per Annex B Section 4) of those Jurisdictions totals at least 95 per cent of the sum of *elimination profit (or loss)* for all Jurisdictions for the Period (giving priority to Jurisdictions with higher *elimination profit (or loss)* over those with lower *elimination profit (or loss)*). A jurisdiction with a negative *elimination profit (or loss)* could never be included in this smallest number of Jurisdictions as there would naturally always be a smaller grouping of Jurisdictions that could satisfy this threshold as compared to any grouping of Jurisdictions that includes a loss Jurisdiction.

354. For example, where a Covered Group has total *elimination profit (or loss)* for a Period among all Jurisdictions of EUR 10 billion, and the five largest Jurisdictions, in terms of *elimination profit (or loss)*, have a combined *elimination profit (or loss)* of EUR 9 450 million with the sixth, seventh and eighth largest Jurisdictions having an *elimination profit (or loss)* in excess of EUR 50 million, it will be the Jurisdiction with the largest *elimination profit (or loss)* among that group of Jurisdictions that will be included as the sixth and final *specified jurisdiction* under this first limb.

355. The second limb includes each Jurisdiction not identified in subparagraph (a) with respect to which *elimination profit (or loss)* is equal to or greater than EUR 50 million for the Period. Under this limb, each of the Jurisdictions mentioned above with *elimination profit (or loss)* equal to or greater than EUR 50 million that was not included in the first limb would be added to the list of *specified jurisdictions*.

356. The third limb includes each Jurisdiction not identified in subparagraph (a) or (b) that satisfies all three criteria listed in subparagraph (c). The first criterion provided in subparagraph (c)(i) is that the *elimination profit (or loss)* (refer Annex B Section 4) of the Jurisdiction must be equal to or greater than EUR 10 million for the Period. The second criterion provided in subdivision (ii) is that the Jurisdictional Return on Depreciation and Payroll *must be* greater than 1 500 per cent of the Return on Depreciation and Payroll for the Covered Group. Finally, the third criterion provided in subdivision (iii) is that the Jurisdiction must have neither a general rate of income tax on business profits of at least 15 per cent nor a domestic minimum top-up tax which raises the effective income tax rate of the Covered Group in that Jurisdiction to 15 per cent or more. The general rate of income tax on business profits mentioned in the first part of subdivision (iii) refers to the nominal corporate income tax rate applicable on business profits in that Jurisdiction. The domestic minimum top-up tax mentioned in the second part of subdivision (iii) is intended to capture any domestic minimum top-up tax, including but not limited to a Qualified Domestic Minimum Top-up Tax defined in the Pillar Two GloBE rules, provided that the applicable domestic minimum tax rate applied is 15 per cent or more.

Article 11 – Allocation of the Obligation to eliminate double taxation with respect to the Amount A relief amount

Paragraph 1

357. Article 11(1) provides that Article 11 determines which *specified jurisdictions* under Article 10 shall be “relieving jurisdictions” with respect to a Covered Group for a Period. Article 11 includes the tiering mechanism that determines the amount of the obligation to provide relief from double taxation of each *relieving jurisdiction*.

Paragraph 2

358. Paragraph 2 contains a number of definitions that are relevant for purposes of this Part.

Subparagraph (a) – Amount A relief amount

359. Subparagraph (a) defines the term “Amount A relief amount” of a Covered Group for a Period. The *Amount A relief amount* for a Covered Group in a Period is the lower of the two amounts provided in subdivisions (i) and (ii). The amount described in (i) is the sum of Amount A Profit allocated to each Jurisdiction under Article 5 plus any *prior unallocated Amount A relief* for the Period. This amount does not include Amount A Profit that would be made to Jurisdictions that do not satisfy the nexus threshold in Article 8 for the Period. However, the amount includes Amount A Profits allocated to the Jurisdictions that are not Parties to the Convention. The amount described in (ii) is the sum of *excess profit* in *specified jurisdictions* available to absorb the Amount A allocations in the period. Where the amount in (ii) is less than the amount in (i) then essentially, there will be a downward adjustment to Amount A relief of the Covered Group for the Period, with the shortfall carried forward to the following period as *prior unallocated amount A relief* (refer to subparagraph (b)).

360. In this context the capacity of *specified jurisdictions* to be allocated *Amount A relief amount* is described in subdivision (ii) and is equal to the sum of all *specified jurisdictions' jurisdictional depreciation and payroll* multiplied by the difference between (i) the applicable *adjusted jurisdictional return on depreciation and payroll* prior to Tier 1 allocations and (ii) Elimination Threshold Return on Depreciation and Payroll. For example, where a group has Elimination Threshold Return on Depreciation and Payroll of 100 per cent and that Group has *adjusted jurisdictional return on depreciation and payroll* prior to Tier 1 allocations in Jurisdiction A of 300 per cent and Jurisdictional Depreciation and Payroll in Jurisdiction A of EUR 1 million, Jurisdiction A would be considered to have capacity of EUR 2 million (=EUR 1 million X (300 per cent – 100 per cent)).

361. For purposes of this subparagraph “the *adjusted jurisdictional return on depreciation and payroll* prior to Tier 1 allocations” is the same measure of jurisdictional profitability that is taken into account for purposes of paragraph 6, and further description of this measure can be found below in the context of subparagraph (c).

362. Where the capacity of all *specified jurisdictions* to be allocated *Amount A relief amount* is less than the sum of Amount A Profit allocated to all Jurisdictions under Article 5 plus any *prior unallocated Amount A relief* for the Period, the *Amount A relief amount* will be capped by this total relief capacity. Any capped amount will be carried forward to subsequent periods as *prior unallocated Amount A relief* (refer to subparagraph (b)).

363. On a Group basis, if the sum of *Amount A profit* allocated to market jurisdictions under Article 5 is EUR 100 million, the *prior unallocated Amount A relief* is EUR 10 million and the sum of capacity of *specified jurisdictions* to be allocated *Amount A relief* (i.e., sum of all *specified jurisdictions' Jurisdictional Depreciation and Payroll* multiplied by the difference between (A) *adjusted jurisdictional return on depreciation and payroll* prior to Tier 1 allocations and (B) Elimination Threshold Return on Depreciation and Payroll) is EUR 90 million, the applicable *Amount A relief amount* will be EUR 90 million (because the lower of EUR 110 million and EUR 90 million would be EUR 90 million). In addition, the deficit of EUR 20 million (=EUR 100 million + EUR 10 million – EUR 90 million) would be carried forward and recognised as *prior unallocated Amount A relief* in the following Period.

Subparagraph (b) – prior unallocated Amount A relief

364. Subparagraph (b) includes the definition of “prior unallocated Amount A relief” that is relevant for the purpose of determining the *Amount A relief amount* described in paragraph 359. In all instances where the Group was not a Covered Group in the preceding Period *the prior unallocated Amount A relief* will be zero under subparagraph (b)(i) and in all other instances *the prior unallocated Amount A relief* will be the amount determined in (b)(ii).

365. Where subparagraph (b)(ii) applies, the *prior unallocated Amount A relief* that can be taken into account in subparagraph (a) to increase the Amount A relief amount in a given Period shall equal any surpluses of Amount A Profit relative to amounts calculated in subparagraph (a)(ii) in each of the previous four Periods respectively to the extent those surpluses have not already been taken into account to increase the Amount A relief amount in an intervening Period. In determining whether those surpluses have already been taken into account to increase the *Amount A relief amount* in an intervening Period, such surpluses should effectively be considered on a first in, first out basis.

366. For example, consider a Covered Group with no *prior unallocated Amount A relief* in Period 1 and with a surplus of Amount A Profit allocated under Article 5 to all Jurisdictions relative to amounts calculated in subparagraph (a)(ii) of EUR 50 million in Period 1 and a further surplus of EUR 50 million in Period 2. As a result, the Covered Group would have *prior unallocated Amount A relief* in year 3 of EUR 100 million.

In year 3, this Covered Group has Amount A Profit of EUR 900 million and relief capacity calculated in subparagraph (a)(ii) of EUR 940 million. In this case, the *prior unallocated Amount A relief* carried forward and recognised in year 4 will be EUR 60 million (i.e., EUR 100 million – (EUR 940 million – EUR 900 million) and this will be considered to be derived EUR 10 million from year 1 and EUR 50 million from year 2. If no *prior unallocated Amount A relief* is taken into account to increase the *Amount A relief amount* in years 4 and 5 (because the Amount A Profit of the Covered Group allocated to all Jurisdictions in Periods 4 and 5 is greater than or equal to the amounts calculated in subparagraph (a)(ii) in each of those Periods), then the *prior unallocated Amount A relief* in year 6 will include EUR 50 million from year 2 but the remaining EUR 10 million from year 1 will cease to be recognised in year 6.

367. Where a *relief entity* is allocated its share of the *Amount A relief amount* in accordance with Article 13 and that share contains an amount of *prior unallocated Amount A relief*, Article 12 ensures that the tax paid by the Designated Payment Entity in the previous Period in relation to the *prior unallocated Amount A relief* will be subject to relief in the current Period. This reflects that due to not all of the previous Period's *Amount A profit* being allocated to *relieving jurisdictions*, the tax paid on such profits under Article 4 is not subject to relief in that Period. Rather the tax paid on such profits is eligible for relief in the later Period when the *prior unallocated Amount A relief* is allocated to a Party.

Subparagraph (c) – adjusted jurisdictional return on depreciation and payroll

368. Subparagraph (c) includes a definition of *adjusted jurisdictional return on depreciation and payroll*. This ratio is determined for each Jurisdiction in a Period for each elimination tier and for each phase within the elimination of double taxation waterfall described in Article 11(6) through (14). It is determined as the Return on Depreciation and Payroll for that *specified jurisdiction* (determined under Annex B Section 5), recalculated after subtracting from the Elimination Profit (or Loss) the amount determined as provided in subdivisions (i) and (ii):

- Under subdivision (i), the amount of the *marketing and distribution profits safe harbour adjustment* of the Covered Group, if any, that is attributable to Elimination Profit (or Loss) of the *specified jurisdiction* under Article 5(1)(b) is excluded.
- However, for purposes of subdivision (i) the amount of the *marketing and distribution profits safe harbour adjustment* applied for that Jurisdiction will be reduced in proportion to the amount of Withholding Tax Upward Adjustment determined for that Jurisdiction for that Period compared to the *adjusted elimination profit (or loss)* for that *specified jurisdiction*.
- Under subdivision (ii), the sum of the *Amount A relief amount*, if any, with respect to which the obligation to eliminate double taxation has already been allocated to that *specified jurisdiction* in a prior tier or a prior phase of Tier 1 under the rules of paragraphs 6 through 15.

369. The subtraction of the *marketing and distribution profits safe harbour adjustment* under subdivision (i) ensures that, to the extent that Amount A Profit is reduced under the *marketing and distribution profits safe harbour adjustment* as a result of Elimination Profit (or Loss) of the Jurisdiction, then a Jurisdiction should not be obliged to provide relief under Article 11 in respect of those same Elimination Profits. This means that where the *marketing and distribution profits safe harbour adjustment* of the Covered Group in that Jurisdiction in the Period is solely attributable to Elimination Profit (or Loss) of the Jurisdiction, then the full amount of the *marketing and distribution profits safe harbour adjustment* is excluded from the Elimination Profit (or Loss) when calculating the Jurisdictional Return on Depreciation and Payroll for the *specified jurisdiction* under subdivision (ii).

370. However, where a *marketing and distribution profits safe harbour adjustment* arises in respect of an “adjusted elimination profit (or loss)” that includes a Withholding Tax Upward Adjustment under Annex B Section 6(1), then the amount of the *marketing and distribution profits safe harbour adjustment* that is excluded from the Elimination Profit (or Loss) when calculating the Jurisdictional Return on Depreciation and Payroll calculated by only taking account of the Elimination Profit (or Loss) part of the “adjusted elimination profit (or loss)”. This is because the Elimination Profit (or Loss) of the Jurisdiction for elimination of double taxation purposes does not take account of any Covered Withholding Taxes collected in the Jurisdiction in the Period and, instead, Covered Withholding Taxes collected in the Jurisdiction are only taken account of for the *marketing and distribution profits safe harbour adjustment* purposes through the Withholding Tax Upward Adjustment under Annex B Section 6(1).

371. Therefore, subdivision (i) provides for a pro-rata calculation of the *marketing and distribution profits safe harbour adjustment* in respect of the portion of the adjustment that relates to Elimination Profit (or Loss) of the Jurisdiction, as illustrated in the example below.

Box 14. Examples: application of Article 11(2)(c) – Pro-rata calculation of the marketing and distribution profits safe harbour adjustment, considering the portion of Withholding Tax Upward Adjustment compared to adjusted elimination profit (or loss)

Example 1

Assume the following basic information for Jurisdiction A (which is a *specified jurisdiction*):

- *Adjusted elimination profit (or loss)* under Article 5(2)(f) of EUR 1 000 that includes:
 - EUR 700 attributable to Elimination Profit (or Loss) under Article 5(2)(f)(i); and
 - EUR 300 attributable to a Withholding Tax Upward Adjustment under Article 5(2)(f)(ii).
- *Adjusted jurisdictional excess profit* under Article 5(2)(c) of EUR 100.
- *Marketing and distribution profits safe harbour adjustment* of EUR 35 under Article 5(2)(a) assuming *jurisdictional offset percentage* is 35 per cent.

As the *adjusted elimination profit (or loss)* of Jurisdiction A for a Period includes EUR 300 attributable to a Withholding Tax Upward Adjustment, subdivision (i) applies for calculating the amount of the *marketing and distribution profits safe harbour adjustment* that is subtracted from the Elimination Profit (or Loss) of the Jurisdiction for Jurisdictional Return on Depreciation and Payroll purposes.

In order to calculate the proportion of the *marketing and distribution profits safe harbour adjustment* of EUR 35 that is attributable to the Elimination Profit (or Loss) of the Jurisdiction, the following calculation should be performed under Article 11(2)(c)(i).

marketing and distribution profits safe harbour adjustment

deduct

*marketing and distribution profits safe harbour adjustment X Withholding Tax Upward Adjustment /
adjusted elimination profit (or loss)*

$$\text{EUR } 35 - \text{EUR } 35 \times \text{EUR } 300 / \text{EUR } 1\,000$$

$$= \text{EUR } 24.5$$

EUR 24.5 would then be subtracted from the Elimination Profit (or Loss) of Jurisdiction A for the adjusted *jurisdictional return on depreciation* calculation under Article 11(2)(c) (i), as follows:

Item	Amount
Elimination Profit (or Loss)	EUR 700
Subtract <i>marketing and distribution profits safe harbour adjustment</i> attributable to Elimination Profit	(EUR 24.5)
Elimination Profit (or Loss) used for calculating <i>adjusted jurisdictional return on depreciation and payroll</i>	EUR 675.5

Example 2

Assume the following basic information for Jurisdiction B (which is also a *specified jurisdiction*):

- *Adjusted elimination profit (or loss)* under Article 5(2)(f) of EUR 2 000 that is solely attributable to Elimination Profit (or Loss) under Article 5(2)(f)(i) and there is no Withholding Tax Upward Adjustment under Article 5(2)(f)(ii).
- *Adjusted jurisdictional excess profit* under Article 5(2)(c) of EUR 500.
- *Marketing and distribution profits safe harbour adjustment* of EUR 175 under Article 5(2)(a) assuming *jurisdictional offset percentage* is 35 per cent.

As the *adjusted elimination profit (or loss)* of Jurisdiction B for a Period solely includes EUR 2,000 attributable to the Elimination Profit (or Loss), subdivision (ii) applies for calculating the amount of the *marketing and distribution profits safe harbour adjustment* that is subtracted from the Elimination Profit (or Loss) of the Jurisdiction for *adjusted jurisdictional return on depreciation and payroll* purposes. This means the full EUR 175 relating to the *marketing and distribution profits safe harbour adjustment* is subtracted, as follows:

Item	Amount
Elimination Profit (or Loss)	EUR 2 000
Subtract <i>marketing and distribution profits safe harbour adjustment</i> attributable to Elimination Profit	EUR 175
Elimination Profit (or Loss) used for calculating <i>adjusted jurisdictional return on depreciation and payroll</i>	EUR 1 825

Paragraph 3

373. Paragraph 3 describes the method through which the obligation to eliminate double taxation is allocated. The paragraph provides that a *specified jurisdiction* shall be a *relieving jurisdiction* with respect to a Covered Group for a Period if that *specified jurisdiction* is allocated the obligation to eliminate double taxation. A *specified jurisdiction* is therefore a Jurisdiction that is a candidate to eliminate double taxation under this process and a *relieving jurisdiction* is one of those candidates that is then obligated to eliminate double taxation.

374. The amount of the obligation to eliminate double taxation is the *Amount A relief amount* allocated to that Jurisdiction under each Tier described in paragraph 5. Paragraphs 4 through 15 describe how the Tiering method operates to allocate the amount of the obligation to eliminate double taxation to a *relieving jurisdiction* under each Tier.

Paragraph 4

375. Paragraph 4 describes the way in which the obligation to eliminate double taxation shall be allocated to *relieving jurisdictions*. The paragraph provides that paragraphs 6 through 15 apply in order to allocate that obligation, with paragraphs 9 through 14 only applying to the extent required in order to fully allocate the *Amount A relief amount* to *relieving jurisdictions*. This allocation process continues until either the full *Amount A relief amount* has been allocated to *relieving jurisdictions* or all paragraphs of this Article have been applied. This means that, for example, Tiers 3A and 3B are only required if the *Amount A relief amount* has not been fully allocated to *relieving jurisdictions* under Tiers 1 and 2.

Paragraph 5

376. Paragraph 5 determines the threshold that is used to determine whether a *specified jurisdiction* is within a particular Tier. There are four Tiers: Tier 1, Tier 2, Tier 3A and Tier 3B. The determination of whether a *specified jurisdiction* is within a particular Tier is a relative test that compares a measure of Return on Depreciation and Payroll in that *specified jurisdiction* with a measure of the Return on Depreciation and Payroll of the Covered Group as a whole.

377. Paragraphs 6 through 8 describe the method for allocating the obligation to eliminate double taxation to *specified jurisdictions* within Tier 1, which follows a “waterfall” approach. Paragraphs 9 and 10 describe the method for allocating the obligation to eliminate double taxation to *specified jurisdictions* within Tier 2, paragraphs 11 and 12 for Tier 3A and paragraphs 13 and 14 for Tier 3B. The obligation to eliminate double taxation is allocated to *specified jurisdictions* within Tiers 2 through 3B following a “pro rata” approach.

378. Subparagraph (a) provides that a *specified jurisdiction* is within Tier 1 if the Covered Group has an *adjusted jurisdictional return on depreciation and payroll* in that *specified jurisdiction* that is greater than both 1500 per cent of the Return on Depreciation and Payroll of the Covered Group and greater than 40 per cent. The *adjusted jurisdictional return on depreciation and payroll* for a *specified jurisdiction* is calculated in paragraph 2(c).

379. Put another way, if the *adjusted jurisdictional return on depreciation and payroll* in a *specified jurisdiction* is greater than 40 per cent and more than fifteen times the Return on Depreciation and Payroll of the Covered Group, then that *specified jurisdiction* is within Tier 1. Tier 1 therefore identifies the *specified jurisdictions* in which the Covered Group has the highest levels of relative profitability, as measured by the Covered Group's *adjusted jurisdictional return on depreciation and payroll* in a *specified jurisdiction* compared to the Return on Depreciation and Payroll of the Covered Group as a whole.

380. Subparagraph (b) provides that a *specified jurisdiction* is within Tier 2 if the Covered Group has an *adjusted jurisdictional return on depreciation and payroll* in that *specified jurisdiction* that is greater than both 150 per cent of the Return on Depreciation and Payroll of the Covered Group and greater than 40 per cent. Put another way, if the *adjusted jurisdictional return on depreciation and payroll* in a *specified jurisdiction* is greater than 40 per cent and more than one and a half times the Return on Depreciation and Payroll of the Covered Group, then that *specified jurisdiction* is within Tier 2.

381. The definition of *adjusted jurisdictional return on depreciation and payroll* in paragraph 2(c) requires that any *Amount A relief amount* that has already been allocated to a *specified jurisdiction* that is in Tier 1 is subtracted from the Elimination Profit (or Loss) used in the calculation of *adjusted jurisdictional return on depreciation and payroll* for a *specified jurisdiction* for purposes of Tier 2. The same is also true for purposes of Tier 3A and Tier 3B, which adjust for any *Amount A relief amount* allocated to a *specified jurisdiction* in a preceding Tier. The operation of the Tiering mechanism means that a *specified jurisdiction* that is within a higher Tier will also be in all subsequent Tiers. For example, a *specified jurisdiction* in Tier 1 will also be in Tiers 2, 3A and 3B (assuming those Tiers are required to fully eliminate double taxation).

382. Subparagraph (c) provides that a *specified jurisdiction* is within Tier 3A if the Covered Group has an *adjusted jurisdictional return on depreciation and payroll* in that *specified jurisdiction* that is greater than both the Elimination Threshold Return on Depreciation and Payroll of the Covered Group and greater than 40 per cent.

383. There are two tests that must be met for a *specified jurisdiction* to be within Tier 1, 2 or 3A: a relative test and an absolute test. If a *specified jurisdiction* fails to meet either of those tests then it will not be within Tier 1, 2 or 3A respectively.

384. The relative test requires that the *adjusted jurisdictional return on depreciation and payroll* in a *specified jurisdiction* is in excess of the Elimination Threshold Return on Depreciation and Payroll of the Covered Group, defined in Article 2(n), or a multiple thereof as applicable to each tier. This requires that the *adjusted jurisdictional return on depreciation and payroll* in a *specified jurisdiction* is in excess of an amount that is equivalent to a 10 per cent *pre-tax profit margin* or a multiple thereof. The absolute test requires that the *adjusted jurisdictional return on depreciation and payroll* in a *specified jurisdiction* is in excess of 40 per cent.

385. Subparagraph (d) provides that a *specified jurisdiction* is within Tier 3B if the Covered Group has an *adjusted jurisdictional return on depreciation and payroll* in that *specified jurisdiction* that is greater than the Elimination Threshold Return on Depreciation and Payroll of the Covered Group. The threshold is therefore identical Tier 3A except that it does not include the absolute test.

Paragraph 6

386. Paragraphs 6 through 8 contain the provisions for Tier 1 of the elimination mechanism. As described in paragraph 5, a *specified jurisdiction* is in Tier 1 if it has an *adjusted jurisdictional return on depreciation and payroll* that is greater than 1500 per cent of the Return on Depreciation and Payroll of the Covered Group and 40 per cent.

387. Paragraph 6 provides the first step to be followed in Tier 1. The paragraph identifies the *specified jurisdiction* in Tier 1 with the highest *adjusted jurisdictional return on depreciation and payroll* for the Covered Group. This *specified jurisdiction* is allocated the obligation to eliminate double taxation for a portion of *Amount A relief amount* that is the lowest of:

- the amount that brings the adjusted jurisdictional return on depreciation and payroll of that specified jurisdiction equal to the adjusted jurisdictional return on depreciation and payroll of the specified jurisdiction with the second highest adjusted jurisdictional return on depreciation and payroll;
- the Amount A relief amount of the Covered Group; and
- the amount that reduces the adjusted jurisdictional return on depreciation and payroll of that specified jurisdiction to the higher of 1 500 per cent of Return on Depreciation and Payroll for the Covered Group and 40 per cent.

388. If the first condition applies, the *relieving jurisdiction* identified in paragraph 6 will not be the only *relieving jurisdiction* that has the obligation to eliminate double taxation in Tier 1. The process for identifying additional *relieving jurisdictions* that will have an obligation to eliminate double taxation within Tier 1 is described in paragraphs 7 and 8.

389. If the second condition applies, the obligation to eliminate double taxation for the Covered Group in the Period will be wholly fulfilled by that *relieving jurisdiction* and double taxation will be fully eliminated within Tier 1.

390. If the third condition applies, then the *adjusted jurisdictional return on depreciation and payroll* of that *relieving jurisdiction* will have been reduced to the threshold for inclusion in Tier 1 (of 1500 per cent of the Return on Depreciation and Payroll of the Covered Group), or the absolute threshold of 40 per cent. The mechanism for eliminating double taxation will continue in Tier 2 if this condition applies.

Paragraph 7

391. Paragraph 7 applies where the portion of the *Amount A relief amount* allocated to the *specified jurisdiction* with the highest *adjusted jurisdictional return on depreciation and payroll* of the Covered Group has been reduced to that of the *specified jurisdiction* with the second highest *adjusted jurisdictional return on depreciation on payroll*, following the approach described in paragraph 6(a) (and described in the first bullet point in paragraph 387 above).

392. Paragraph 7 requires that the obligation to eliminate double taxation with respect to the *Amount A relief amount* is allocated to those two *specified jurisdictions* (which are the *specified jurisdiction* with the highest and second highest *adjusted jurisdictional return on depreciation and payroll* for the Covered Group). The obligation to relieve double taxation with respect to the *Amount A relief amount* is allocated to those two *specified jurisdictions* in proportion such that the *adjusted jurisdictional return on depreciation and payroll* of those two *specified jurisdictions* is reduced so that the *adjusted jurisdictional return on depreciation and payroll* of those *specified jurisdictions* remains equal.

393. These two *specified jurisdictions* are allocated the obligation to eliminate double taxation for a portion of *Amount A relief amount* that is the lowest of:

- the amount that brings the adjusted jurisdictional return on depreciation and payroll of those two specified jurisdictions equal to the adjusted jurisdictional return on depreciation and payroll of the specified jurisdiction with the third highest adjusted jurisdictional return on depreciation and payroll;
- the Amount A relief amount of the Covered Group; and

- the amount that reduces the adjusted jurisdictional return on depreciation and payroll of those two specified jurisdictions to the higher of 1 500 per cent of the Return on Depreciation and Payroll for the Covered Group or 40 per cent.

394. This approach follows the same principles as those in paragraph 6.

Paragraph 8

395. Paragraph 8 applies where the portion of the *Amount A relief amount* allocated to the *specified jurisdictions* with the highest and second highest *adjusted jurisdictional return on depreciation and payroll* of the Covered Group have been reduced to that of the *specified jurisdiction* with the third highest *adjusted jurisdictional return on depreciation and payroll*, following the approach described in paragraph 7(a) (and described in the first bullet point in paragraph 392 above).

396. Paragraph 8 requires that the obligation to eliminate double taxation is then allocated to those three *specified jurisdictions* (which are the *specified jurisdiction* with the highest, second highest and third highest *adjusted jurisdictional return on depreciation and payroll* for the Covered Group). Paragraph 8 provides that this process continues iteratively to each additional *specified jurisdiction* in Tier 1, starting with the *specified jurisdiction* with the next highest *adjusted jurisdictional return on depreciation and payroll*, until:

- the *Amount A relief amount* has been fully allocated to *specified jurisdictions* in Tier 1; or
- the *adjusted jurisdictional return on depreciation and payroll* of the *specified jurisdictions* in Tier 1 is reduced to the higher of 1500 per cent of the Return on Depreciation and Payroll for the Covered Group or 40 per cent.

397. Where the first bullet point applies, the obligation to eliminate double taxation will have been fully allocated and there is no need to consider the application of the other Tiers. Where the second bullet point applies, Tier 2 shall apply.

Paragraph 9

398. Paragraph 9 provides that if the obligation to eliminate double taxation has not been fully satisfied in Tier 1, then the *specified jurisdictions* in Tier 2 shall have an obligation to eliminate double taxation with respect to the *Amount A relief amount* of the Covered Group for the Period.

399. Paragraph 9 provides that the obligation will be allocated to a *specified jurisdiction* in Tier 2 in proportion to the ratio of the *jurisdictional Tier 2 excess profit* of that *specified jurisdiction* to the sum of the *jurisdictional Tier 2 excess profit* of all *specified jurisdictions* in Tier 2. This means that a *specified jurisdiction* is allocated the obligation to eliminate double taxation in proportion to its share of the total *Amount A relief amount* of the Covered Group that is within Tier 2. The term “jurisdictional Tier 2 excess profit” is defined in paragraph 10.

400. Under paragraph 9, any *Amount A relief amount* remaining after allocation to the *specified jurisdictions* in Tier 1 is allocated to each *specified jurisdiction* in Tier 2 in proportion to its fraction of the total *jurisdictional Tier 2 excess profit* for all *specified jurisdictions* in Tier 2. The total amount allocated to jurisdictions in Tier 2 is the lower of:

- The amount that ensures that the *Amount A relief amount* has been fully allocated to *specified jurisdictions* in Tiers 1 and 2; or

- The amount that reduces the *adjusted jurisdictional return on depreciation and payroll* of the *specified jurisdictions* in Tier 2 to the higher of 150 per cent of the Return on Depreciation and Payroll of the Covered Group or 40 per cent.

401. Where the first bullet point applies, the obligation to eliminate double taxation will have been fully allocated and there is no need to consider the application of the other Tiers. Where the second bullet point applies, Tier 3A shall apply.

Paragraph 10

402. Paragraph 10 provides the definition of “jurisdictional Tier 2 excess profit” of a *specified jurisdiction*. The definition is used to calculate the extent of the obligation to eliminate double taxation of a *specified jurisdiction* in accordance with the Tier 2 threshold. It is a calculation of the profits arising in a *specified jurisdiction* that fall within Tier 2 and therefore might be used to eliminate double taxation with respect to the *Amount A relief amount*. The *jurisdictional Tier 2 excess profit* is the higher of zero, or the amount calculated under subparagraphs (a) and (b).

403. Subparagraph (a) is the amount calculated by subtracting the higher of 150 per cent of the Return on Depreciation and Payroll of the Covered Group and 40 per cent from the *adjusted jurisdictional depreciation and payroll* of the *specified jurisdiction*.

404. Once the amount in subparagraph (a) has been calculated, subparagraph (b) requires that amount to be multiplied by the *jurisdictional depreciation and payroll* of that *specified jurisdiction*.

405. The calculation aligns with paragraph 5(b) in that a *specified jurisdiction* will not be obliged to eliminate double taxation within Tier 2 with respect to the *Amount A relief amount* if the *adjusted jurisdictional return on depreciation and payroll* of that *specified jurisdiction* is less than the greater of 150 per cent of the Return on Depreciation and Payroll of the Covered Group and 40 per cent.

Paragraph 11

406. Paragraph 11 provides that if the obligation to eliminate double taxation has not been fully satisfied in Tiers 1 and 2, then the *specified jurisdictions* in Tier 3A shall have an obligation to eliminate double taxation with respect to the *Amount A relief amount* of the Covered Group for the Period.

407. Paragraph 11 provides that the obligation will be allocated to a *specified jurisdiction* in Tier 3A in proportion to the ratio of the *jurisdictional Tier 3A excess profit* of that *specified jurisdiction* to the sum of the *jurisdictional Tier 3A excess profit* of all *specified jurisdictions* in Tier 3A. The term “jurisdictional Tier 3A excess profit” is defined in paragraph 12. The approach in Tier 3A is therefore identical to that taken in Tier 2, but the *jurisdictional adjusted return on depreciation and payroll* threshold for a *specified jurisdiction* to fall within Tier 3A is lower than for Tier 2.

408. Under paragraph 11, any *Amount A relief amount* remaining after allocation to the *specified jurisdictions* in Tier 2 is allocated to each *specified jurisdiction* in Tier 3A in proportion to its fraction of the total jurisdictional Tier 3A *Amount A relief amount* for all *specified jurisdictions* in Tier 3A. The total amount allocated to Jurisdictions in Tier 3A is the lower of:

- The amount that ensures that the Amount A relief amount has been fully allocated to specified jurisdictions in Tiers 1, 2, and 3A; or

- The amount that reduces the adjusted jurisdictional return on depreciation and payroll of the specified jurisdictions in Tier 3A to the higher of the Elimination Threshold Return on Depreciation and Payroll of the Covered Group and 40 per cent.

409. The Elimination Threshold Return on Depreciation and Payroll of the Covered Group is defined in Article 2(n).

410. Where the first bullet point applies, the obligation to eliminate double taxation will have been fully allocated and there is no need to consider the application of the other Tiers. Where the second bullet point applies, Tier 3B shall apply.

Paragraph 12

411. Paragraph 12 provides the definition of “jurisdictional Tier 3A excess profit” of a *specified jurisdiction*.

412. The definition is used to calculate the extent of the obligation to eliminate double taxation of a *specified jurisdiction* in accordance with the Tier 3A threshold. It is a calculation of the profits arising in a *specified jurisdiction* that fall within Tier 3A and therefore might be used to eliminate double taxation with respect to the *Amount A relief amount*. The *jurisdictional Tier 3A excess profit* is the higher of zero, or the amount calculated under subparagraphs (a) and (b).

413. Subparagraph (a) is the amount calculated by subtracting the higher of the Elimination Threshold Return on Depreciation and Payroll of the Covered Group and 40 per cent from the *adjusted jurisdictional depreciation and payroll* of the *specified jurisdiction*.

414. Once the amount in subparagraph (a) has been calculated, subparagraph (b) requires that amount to be multiplied by the *jurisdictional depreciation and payroll* of that *specified jurisdiction*.

415. The calculation aligns with paragraph 5(c) in that a *specified jurisdiction* will not be obliged to eliminate double taxation within Tier 3A with respect to the *Amount A relief amount* if the *adjusted jurisdictional return on depreciation and payroll* of that *specified jurisdiction* is less than the greater of the Elimination Threshold Return on Depreciation and Payroll of the Covered Group and 40 per cent.

Paragraph 13

416. Paragraph 13 provides that if the obligation to eliminate double taxation has not been fully satisfied in Tiers 1, 2 and 3A then the *specified jurisdictions* in Tier 3B shall have an obligation to eliminate double taxation with respect to the *Amount A relief amount* of the Covered Group for the Period.

417. Paragraph 13 provides that the obligation will be allocated to a *specified jurisdiction* in Tier 3B in proportion to the ratio of the *jurisdictional Tier 3B excess profit* of that *specified jurisdiction* to the sum of the *jurisdictional Tier 3B excess profit* of all *specified jurisdictions* in Tier 3B. The term “jurisdictional Tier 3B excess profit” is defined in paragraph 14. The approach in Tier 3B is therefore identical to that taken in Tiers 2 and 3A, but the *jurisdictional adjusted return on depreciation and payroll* threshold for a *specified jurisdiction* to fall within Tier 3B is lower than that for Tiers 3A because it does not include an absolute threshold of 40 percent.

418. Under paragraph 13, any *Amount A relief amount* remaining after allocation to the *specified jurisdictions* in Tier 3A is allocated to each *specified jurisdiction* in Tier 3B in proportion to its fraction of the

total jurisdictional Tier 3B *Amount A relief amount* for all *specified jurisdictions* in Tier 3B. The total amount allocated to Jurisdictions in Tier 3B is the lower of:

- The amount that ensures that the *Amount A relief amount* has been fully allocated to *specified jurisdictions* in Tiers 1, 2, 3A, and 3B; or
- The amount that reduces the *adjusted jurisdictional return on depreciation and payroll* of the *specified jurisdictions* in Tier 3B to the Elimination Threshold Return on Depreciation and Payroll of the Covered Group.

419. The Elimination Threshold Return on Depreciation and Payroll of the Covered Group is defined in Article 2(n).

Paragraph 14

420. Paragraph 14 provides the definition of “jurisdictional Tier 3B excess profit” of a *specified jurisdiction*.

421. The definition is used to calculate the extent of the obligation to eliminate double taxation of a *specified jurisdiction* in accordance with the Tier 3B threshold. It is a calculation of the profits arising in a *specified jurisdiction* that fall within Tier 3B and therefore might be used to eliminate double taxation with respect to the *Amount A relief amount*. The *jurisdictional Tier 3B excess profit* is the higher of zero, or the amount calculated under subparagraphs (a) and (b).

422. Subparagraph (a) is the amount calculated by subtracting the Elimination Threshold Return on Depreciation and Payroll of the Covered Group from the *adjusted jurisdictional depreciation and payroll* of the *specified jurisdiction*.

423. Once the amount in subparagraph (a) has been calculated, subparagraph b) requires that amount to be multiplied by the *jurisdictional depreciation and payroll* of that *specified jurisdiction*.

424. The calculation aligns with paragraph 5(d) in that a *specified jurisdiction* will not be obliged to eliminate double taxation within Tier 3B with respect to the *Amount A relief amount* if the *adjusted jurisdictional return on depreciation and payroll* of that *specified jurisdiction* is equal to the Elimination Threshold Return on Depreciation and Payroll of the Covered Group.

Box 15. Example – Allocation of the obligation to eliminate double taxation

Step 1. Determining Tier thresholds based on the Return on Depreciation and Payroll of the Covered Group

For purposes of this example, consider that a Covered Group has an Adjusted Profit Before Tax of EUR 450 million. The sum of the *accounting depreciation* and *accounting payroll* is EUR 350 million. Therefore, the Return on Depreciation and Payroll of the Covered Group is 129% (= 450 million / 350 million)⁵.

⁵ Please note that all figures in this example have been rounded. However, the precise numbers are the basis for the following calculations. Thus, gaps in the equations between the precise numbers and the displayed rounded numbers might occur.

To fall in Tier 1, a *specified jurisdiction* must have an *adjusted jurisdictional return on depreciation and payroll* greater than 1 500% of the Return on Depreciation and Payroll of the Covered Group, which is 1 929% (=1 500% X 450 million / 350 million). The *adjusted jurisdictional return on depreciation and payroll* of the *specified jurisdiction* must also be greater than 40%.

To fall in Tier 2, a *specified jurisdiction* must have an *adjusted jurisdictional return on depreciation and payroll* greater than 150% of the Return on Depreciation and Payroll of the Covered Group, which is 193% (=150% X 450 million / 350 million). The *adjusted jurisdictional return on depreciation and payroll* of the *specified jurisdiction* must also be greater than 40%.

Step 2. Determining which Tier each Jurisdiction belongs to

	Jurisdiction A	Jurisdiction B	Jurisdiction C
Elimination Profit (or Loss)	EUR 200 million	EUR 150 million	EUR 15 million
Jurisdictional Depreciation and Payroll	EUR 5 million	EUR 7.5 million	EUR 6 million
<i>Adjusted jurisdictional return on depreciation and payroll</i>	4 000%	2 000%	250%
Tier to which a Jurisdiction belongs	Tier 1 (4 000% > 1 929%, 40%)	Tier 1 (2 000% > 1 929%, 40%)	Tier 2 (250% < 1 929% 250% > 193%)

In Jurisdiction A, the Covered Group has an Adjusted Profit Before Tax of EUR 200 million and a *jurisdictional depreciation and payroll* of EUR 5 million. The *adjusted jurisdictional return on depreciation and payroll* in Jurisdiction A is therefore 4 000% (= 200 million / 5 million). This is in excess of 1 500% of the Return on Depreciation and Payroll of the Covered Group (4 000% > 1 929%), and in excess of 40%. Jurisdiction A is therefore in Tier 1.

In Jurisdiction B, the Covered Group has an Adjusted Profit Before Tax of EUR 150 million and a *jurisdictional depreciation and payroll* of EUR 7.5 million. The *adjusted jurisdictional return on depreciation and payroll* in Jurisdiction B is therefore 2 000% (= 150 million / 7.5 million). This is in excess of 1 500% of the Return on Depreciation and Payroll of the Covered Group (2 000% > 1 929%), and in excess of 40%. Jurisdiction B is therefore in Tier 1.

In Jurisdiction C, the Covered Group has an Adjusted Profit Before Tax of EUR 15 million and a *jurisdictional depreciation and payroll* of EUR 6 million. Its *adjusted jurisdictional return on depreciation and payroll* in Jurisdiction C is therefore 250% (= 15 million / 6 million). This is not in excess of 1 500% of the Return on Depreciation and Payroll of the Covered Group, although it is in excess of 40%. Jurisdiction C is therefore not in Tier 1. However, the *adjusted jurisdictional return on depreciation and payroll* in Jurisdiction C exceeds 150% of the Return on Depreciation and Payroll of the Covered Group (250% > 193%). Jurisdiction C is therefore in Tier 2.

Step 3. Allocating the obligation to eliminate double taxation in Tier 1

Assume that Jurisdictions A, B and C are the only *specified jurisdictions* with respect to the Covered Group for the Period according to Article 10 and the *Amount A relief amount* of the Covered Group for the Period is EUR 200 million. As Jurisdiction A has the highest *adjusted return on depreciation and payroll* in Tier 1, it is allocated the obligation to eliminate double taxation with respect to a portion of the *Amount A relief amount* first (see Article 11(6)). Jurisdiction A would be first allocated with the obligation to relieve EUR 100 million, because this reduces its *adjusted return on depreciation and payroll* to 2 000%, which is equal to the *adjusted return on depreciation and payroll* of Jurisdiction B, which is also in Tier 1. This is the lowest of the amounts described in Article 11(6) as the *Amount A relief amount* is EUR 200 million and the *adjusted return on depreciation and payroll* of Jurisdiction A is still in excess of 1 500% of the Return on Depreciation and Payroll for the Covered Group.

Thus, both Jurisdiction A and Jurisdiction B are allocated the obligation to eliminate double taxation with respect to a portion of the *Amount A relief amount* of the Covered Group in Tier 1. This means that Jurisdiction A will be allocated a further EUR 3.6 million (reducing its *adjusted return on depreciation and payroll* to 1 929%). Jurisdiction B will be allocated EUR 5.4 million (reducing its *adjusted return on depreciation and payroll* to 1 929%).

The result is that Jurisdiction A is allocated the obligation to eliminate double taxation with respect to a total of EUR 103.6 million and Jurisdiction B EUR 5.4 million. As the total amount for which the obligation to eliminate double taxation with respect to the *Amount A relief amount* of the Covered Group in Tier 1 (i.e., EUR 109 million) is less than the *Amount A relief amount* (i.e., EUR 200 million), Tier 2 applies to allocate the remaining obligation to eliminate double taxation of EUR 91 million.

	Jurisdiction A	Jurisdiction B	Jurisdiction C
<i>Amount A relief amount</i> in Tier 1 allocated to the jurisdiction with the highest Jurisdictional Return on Depreciation and Payroll	EUR 100 million	-	-
<i>Amount A relief amount</i> in Tier 1 allocated to the jurisdiction with the second highest Jurisdictional Return on Depreciation and Payroll	EUR 3.6 million	EUR 5.4 million	-
<i>Total Amount A relief amount</i> in Tier 1	EUR 103.6 million	EUR 5.4 million	-

Step 4. Allocating the obligation to eliminate double taxation in Tier 2

The obligations to eliminate double taxation with respect to a portion of the *Amount A relief amount* in Tier 2 is described in Article 11(9). The *jurisdictional Tier 2 excess profit* of Jurisdiction A is EUR 86.8 million⁶. The *jurisdictional Tier 2 excess profit* of Jurisdiction B is EUR 130.2 million⁷. The *jurisdictional Tier 2 excess profit* of Jurisdiction C is EUR 3.4 million⁸. 150% of the Return on Depreciation and Payroll of the Covered Group (i.e., 193%) is higher than 40% in each case and this is the figure deducted from the *adjusted jurisdictional return on depreciation and payroll* of each Jurisdiction.

	Jurisdiction A	Jurisdiction B	Jurisdiction C	Total
<i>Jurisdictional Tier 2 excess profit</i>	EUR 86.8 million	EUR 130.2 million	EUR 3.4 million	EUR 220.4 million
Proportionate ratio of the <i>jurisdictional Tier 2 excess profit</i>	39%	59%	2%	100%
<i>Amount A relief amount</i> allocated to each Jurisdiction in Tier 2	EUR 35.8 million	EUR 53.8 million	EUR 1.4 million	EUR 91 million

The sum of *jurisdictional Tier 2 excess profit* of all *specified jurisdictions* in Tier 2 is therefore EUR 220.4 million. The ratio of Jurisdiction A's share is 39% (= 86.8/220.4), Jurisdiction B 59% (=130.2/220.4) and Jurisdiction C 2% (=3.4/220.4).

The *Amount A relief amount* remaining after Tier 1 is EUR 91 million (i.e., total *Amount A relief amount* EUR 200 million minus the amount already relieved in Tier 1, which is EUR 109 million). As this is less than the sum of *jurisdictional Tier 2 excess profit* (i.e., EUR 220.4 million), the *Amount A relief amount* will be allocated to each *specified jurisdiction* in proportion to the ratios calculated above.

Jurisdiction A = EUR 35.8 million (= 39% x EUR 91 million)

Jurisdiction B = EUR 53.8 million (= 59% x EUR 91 million)

Jurisdiction C = EUR 1.4 million (= 2% x EUR 91 million)

The *adjusted jurisdictional return on depreciation and payroll* of Jurisdictions A, B and C remains above 150% of the Return on Depreciation and Payroll of the Covered Group. As such the obligation to eliminate double taxation with respect to a portion of the *Amount A relief amount* is determined in accordance with Article 11(9)(a).

The total relief provided by each *relieving jurisdiction* is therefore as follows:

Jurisdiction A: EUR 103.6 million + EUR 35.8 million = EUR 139.4 million

Jurisdiction B: EUR 5.4 million + EUR 53.8 million = EUR 59.2 million

Jurisdiction C: EUR 1.4 million

⁶ EUR 86.8 million = (1 929% - 193%) X EUR 5 million

⁷ EUR 130.2 million = (1 929% - 193%) X EUR 7.5 million

⁸ EUR 3.4 million = (250% - 193%) X EUR 6 million

	Jurisdiction A	Jurisdiction B	Jurisdiction C	Total
<i>Amount A relief amount</i> in Tier 1	EUR 103.6 million	EUR 5.4 million	-	EUR 109 million
<i>Amount A relief amount</i> in Tier 2	EUR 35.8 million	EUR 53.8 million	EUR 1.4 million	EUR 91 million
Total	EUR 139.4 million	EUR 59.2 million	EUR 1.4 million	EUR 200 million

Paragraph 15

425. Paragraph 15 provides that, notwithstanding paragraph 2(a), with respect to any Jurisdiction that was a non-participating Jurisdiction (i.e., a Jurisdiction that is not a Party to the Convention) in the immediately preceding Period, the *Amount A relief amount* allocated to that Jurisdiction only will be calculated in the current Period as if the *prior unallocated Amount A relief* was not included in the *Amount A relief amount* determined from the Covered Group perspective. In this way, when a new participating Jurisdiction is added as a party to the Convention, its allocation of *Amount A relief amounts* will be determined as though the entire *Amount A relief system* had been determined in the Period without *prior unallocated Amount A relief*. This provision applies independently of any domestic law provisions that might reduce the amount of actual double taxation relief recognised for the purpose of determining a domestic tax liability to be less than the allocated *Amount A relief amount* (refer to Article 13(4)); likewise, any such domestic laws that reduce the amount of actual double taxation relief provided will not affect the calculation of the *Amount A relief amount* (including the *prior unallocated Amount A relief*) under Article 11.

426. For instance, suppose that Jurisdiction A was a non-participating Jurisdiction in Year 1, and joined the Convention in Year 2. It qualified for being a *relieving jurisdiction* under Article 11(1) in Year 2. The *prior unallocated Amount A relief* for the Covered Group attributable in Year 2 was EUR 20 million (determined as described in paragraph 364), and the *Amount A relief amount* for Year 2 is EUR 100 million (including the *prior unallocated Amount A relief* of EUR 20 million). As a result of paragraph 15, for the purpose of determining the *Amount A relief Amount* allocated to Jurisdiction A only, the *Amount A relief amount* for the purpose of applying the waterfall used to determine its *Amount A relief amount* (if any) would be EUR 80 million and this amount would be used as the basis for performing the full *Amount A relief allocation calculations* under Article 11(6) through (14) with respect to Jurisdiction A. In relation to all other *specified Jurisdictions* that were participating Jurisdictions in Year 1, for the purpose of determining the *Amount A relief amount* allocated to those Jurisdictions, the *Amount A relief amount* taken into account would be EUR 100 million and this amount would be used as the basis for performing the full *Amount A relief allocation calculations* under Article 11(6) through (14) with respect to those Jurisdictions. Under this approach, the sum of the *Amount A relief amounts* allocated to each Jurisdiction would be less than the *Amount A relief amount* determined at a Covered Group level under paragraph 11(2)(a).

427. Article 11(15) will not affect the *Amount A relief amount* allocated to any other Jurisdiction. In the event that the *Amount A relief amount* is reduced for a previously non-participating Jurisdiction by virtue of this Paragraph, the *Amount A relief amount* of all other *relieving jurisdictions* remains unchanged. For example, if the total *Amount A relief amount* of the Group is 1000 (including 100 of *prior unallocated Amount A relief*) and the resulting *Amount A relief amount* allocating to Jurisdiction A and B would be 500 each in the absence of this provision, if Jurisdiction A only was a non-participating Jurisdiction in the previous Period, its *Amount A relief amount* would be reduced by this Paragraph 15 and Jurisdiction B

would remain unaffected. The amount by which Jurisdiction A has its *Amount A relief amount* reduced under this provision will not be taken into account in subsequent periods (as it would not result in additional *prior unallocated Amount A relief* according to paragraph 365), and this reduced relief amount will essentially be unrelieved.

Article 12 – Provision of relief for Amount A taxation to relief entities

428. Article 12 obliges Parties to provide relief for Amount A taxation. The Article stipulates that a Party that is a *relieving jurisdiction* with respect to a portion of the *Amount A relief amount* of a Covered Group under Article 11 must provide relief from double taxation to each *relief entity* identified under Article 13.

Paragraph 1

429. Paragraph 1 outlines the methods by which Parties are required to provide double taxation relief for amounts taxed in accordance with the Convention. The authorised methods are as follows:

- direct payment;
- refundable tax credit;
- non-refundable tax credit; or
- deduction.

430. Paragraph 1 is not intended to specify the amount of double taxation relief available to a *relief entity*, but rather create an obligation on a Party to provide relief to *relief entities* for tax paid by a Designated Payment Entity in accordance with Article 4 using one of these four agreed methods. Paragraph 2 authorises a Party to determine the amount of relief provided to a *relief entity* under any of the authorised methods provided in this paragraph subject to the conditions specified by:

- Paragraphs 3 and 4, which are intended to place certain obligations on Parties in how double taxation relief is provided; and
- Article 13(7), which requires double taxation relief to be contingent on *relief entities* providing compensation payments to the Designated Payment Entity.

431. Under each authorised method in paragraph 1, a Party identified by Article 11 shall provide relief in respect of tax paid by the Designated Payment Entity with respect to the share of the *Amount A relief amount* allocated to the *relief entity* under Article 13, or in the case of a deduction, in respect of the share of the *Amount A relief amount* that is allocated to the *relief entity*.

432. This reflects that *relief entities* are entitled to relief based on the taxation legally borne by the Designated Payment Entity of the Covered Group in accordance with Article 4. As noted in Article 4, the adoption of a single taxpayer model has been implemented to reduce the administrative compliance burden for Covered Groups and tax administrations. Notwithstanding this, the interaction of Articles 4 and 12, and the compensation payment provisions in Article 13(6) through (11) is intended to ensure that the *relief entities* identified in accordance with Article 13 compensate the Designated Payment Entity for the tax liabilities related to Amount A Profit in an amount that is equal to the *Amount A compensation payment limit*. It is thus consistent that relief from double taxation is provided to those entities that bear the economic

burden of taxation under the Convention. However, relief will still similarly be provided in circumstances where, if permitted by a Party, a lower compensation amount that is in accordance with the *relief entity's* obligations specified in a *Covered Group's Amount A funding agreement*, is made (refer to Article 13(11)).

433. The three first authorised methods (direct payment, refundable tax credit and non-refundable tax credit) are defined by reference to the “relevant portion of the tax paid by the Designated Payment Entity”. The term “relevant portion of the tax paid by the Designated Payment Entity” is defined by paragraph 7(a) as the product of two components.

434. The first component is the “*aggregate tax paid by the Designated Payment Entity in accordance with Article 4 that is attributable to the Amount A relief amount of the Covered Group allocated to relieving jurisdictions that are Parties*”. The restriction to tax paid that is “*attributable to the Amount A relief amount of the Covered Group allocated to relieving jurisdictions that are Parties*” is intended to delineate the part of the tax paid by the Designated Payment Entity that is not eligible for relief, in two different situations outlined below:

- First, when after the transition period of two years (as defined by Article 4(3)), a *relieving jurisdiction* is not a Party and has no agreement for the avoidance of double taxation with a market jurisdiction, the amount of Amount A Profit that the market jurisdiction is allowed to tax is not reduced. However, *relieving jurisdictions* that are Parties to the Convention are not required to bear any burden in relation to such tax. As such tax is attributable to a portion of the *Amount A relief amount* allocated to a *relieving jurisdiction* that is not a Party, it should be disregarded from the tax paid by the Designated Payment Entity, for which a *relief entity* is eligible to relief from double taxation.
- Second, when in a given Period, under Article 11, a portion of the *Amount A relief amount* has not been allocated to *relieving jurisdictions*, a corresponding proportion of the tax paid by the Designated Payment Entity will not be eligible for relief in relation to that Period. However, in the following Period, this *prior unallocated Amount A relief* will be included in the *Amount A relief amount* of that Period as per Article 11(2)(a); hence, the tax paid by the Designated Payment Entity in the previous Period corresponding to the *prior unallocated Amount A relief* should be included in the tax paid that is eligible for relief in the following Period.

435. The second component is the ratio of the *Amount A relief amount* allocated to the *relief entity* under Article 13(1) through (5) to the *Amount A relief amount* of the Covered Group allocated to all *relieving jurisdictions* that are Parties. This ensures that all the tax paid by the Designated Payment Entity, subject to the above-described qualifications, is apportioned between all the *relief entities* in the *relieving jurisdictions* that are Parties to the Convention, on the same basis as if the *relief entities* in the *relieving jurisdiction* were directly liable for the tax.

436. It must be noted that, in circumstances where a market jurisdiction is not a Party to the Convention, no tax can be levied under Article 4. Therefore, although the Amount A Profit and *Amount A relief amount* are defined irrespective of the participation of Jurisdictions to the Convention, the *relieving jurisdictions* will not bear any relief burden in relation to Amount A Profit allocated to non-Parties.

437. The fourth authorised method (the deduction) is defined as the deduction of the *adjusted Amount A relief amount allocated to the relief entity* from the income used to calculate the tax liability of the *relief entity* in the Party for the fiscal year. The “adjusted Amount A relief amount allocated to the relief entity” is defined in paragraph 7. As the *Amount A relief amount* is determined in Article 11(2) by taking into account all Jurisdictions, irrespective of their participation to the Convention, an obligation to provide relief based on the equivalent of the entire share of the *Amount A relief amount* allocated to a *relief entity* may lead to an excessive obligation in cases where Article 5 allocated Amount A Profit to a Jurisdiction that is not a

Party to the Convention and therefore not subject to tax. This is why the “adjusted Amount A relief amount allocated to the relief entity” is reduced in proportion to the share of Amount A Profit that is not subject to tax under Article 4 because it is allocated to non-Party market jurisdictions under Article 5.

438. Specific adjustments to the above described components apply in circumstances covered by paragraph 8, i.e. where the *relief entity* is in a Jurisdiction described in Article 11(15).

Box 16. Examples – Articles 11(5) and 12(1)

Example 1 – Non-participating relieving jurisdiction

ABC Group is a Covered Group for Amount A purposes. The UPE of the Group, ABC plc, is resident for tax purposes in Jurisdiction A, a Jurisdiction which has ratified the MLC. ABC plc has a Period of 1 January to 31 December for Amount A purposes. ABC plc is the Designated Payment Entity and *coordinating entity* for the Group.

ABC Group’s sole market jurisdiction for Amount A purposes is Jurisdiction B. ABC Group’s *relieving jurisdictions* are Jurisdiction C, Jurisdiction D, Jurisdiction E. ABC plc owns and controls the following entities:

- Entity C in Jurisdiction C;
- Entity D in Jurisdiction D; and
- Entity E in Jurisdiction E.

Transition period (FY25)

ABC Group is in scope of the Amount A rules for the first time for the Period 1 January 2025 to 31 December 2025 (FY25). For FY25, Jurisdiction B, Jurisdiction C and Jurisdiction D have ratified the MLC. However, Jurisdiction E, which has been identified as a *relieving jurisdiction* for FY25 has not ratified the MLC. Jurisdiction B and Jurisdiction E do not have an agreement for the avoidance of double taxation with respect to taxes on income with each other.

For FY25, ABC Group has Amount A Profit of 1000, all of which is attributable to Jurisdiction B. Amount A Profit is subject to tax at the rate of 25% in Jurisdiction B.

For FY25, Jurisdiction C, Jurisdiction D, and Jurisdiction E have *Amount A relief amounts* of 600, 200, and 200 respectively. In the transition period, as provided for under Article 4(3), the Amount A Profit which Jurisdiction B is allowed to tax is adjusted to reflect the fact that a portion of the *Amount A relief amount* is borne by a non-participating jurisdiction (Jurisdiction E).

The amount of Amount A Profit taxable in Jurisdiction B is reduced by: $1000 * (200/1000) = 200$. Therefore, the Amount A Profit subject to tax in Jurisdiction B is $(1000 - 200 = 800)$. ABC plc pays tax of $(800 * 25\% = 200)$ in Jurisdiction B on this Amount A Profit.

For the purpose of determining their relieving obligations for FY25, Jurisdiction C and Jurisdiction D need to determine the relevant portion of the *Amount A relief amount* of a Covered Group under Article 11 with respect to which they should provide relief from double taxation to each *relief entity* identified under Article 13. Given Entity C and Entity D are the only Group Entities within the respective

Jurisdictions, those entities are identified as *relief entities* under the domestic laws of Jurisdiction C and Jurisdiction D.

Jurisdiction C provides relief to Entity C through a mechanism provided for in Article 12(1)(a) through (c), with respect to the tax paid by the DPE in relation to Entity C's portion of the *Amount A relief amount*. The portion of the *Amount A relief amount* attributable to Entity C is calculated as $600 / 800$ (800 being the 1000 *Amount A relief amount* of the Covered Group less the 200 *Amount A relief amount* attributable to Jurisdiction E, a non-Party to the Convention), being 75%. Therefore, the relief obligation for Jurisdiction C applicable to Entity C is in respect of 150 of tax paid by the DPE ($200 * 75\% = 150$). The relief to be provided in relation to this 150 of tax is determined under the domestic law of Jurisdiction C (per Article 12(2)) and subject to the guardrails provided in Article 12(3) through (5).

Jurisdiction D also provides relief through a mechanism provided for in Article 12(1)(a) through (c). It will apply the same adjustment in determining its relieving obligation in relation to Entity D. Therefore, the relief obligation for Jurisdiction D applicable to Entity D is in respect of 50 of tax paid by the DPE ($200 * 25\% = 50$). The relief to be provided in relation to this 50 of tax is determined under the domestic law of Jurisdiction D (per Article 12(2)) and subject to the guardrails provided in Article 12(3) through (5).

If Jurisdiction D provides relief via the mechanism in Article 12(1)(d) (a deduction), the obligation to provide relief should be in respect of the *adjusted Amount A relief amount allocated to the relief entity* of 200. This being $200 \times (1000/1000)$. This reflects that no adjustment is required as there is no Amount A Profit allocated under Article 5 to a Jurisdiction that is not a Party. The relief to be provided in relation to the *adjusted Amount A relief amount allocated to the relief entity* is determined under the domestic law of Jurisdiction D and subject to the guardrails provided in Article 12(3) through (5).

Post transition period

After the expiration of the transition period provided under Article 4(3), ABC Group will need to consider whether adjustments will need to be made.

By the end of FY27, Jurisdiction E has not ratified the MLC. Assume for FY27 that ABC Group has the same market jurisdiction, *relieving jurisdictions*, *relief entities* and allocations of Amount A Profit and *Amount A relief amount* as per FY25.

In this scenario, the Amount A Profit subject to tax in Jurisdiction B will not be adjusted to reflect the fact that a portion of the *Amount A relief amount* is borne by a non-participating jurisdiction (Jurisdiction E) as there is no agreement for the avoidance of double taxation with respect to taxes on income between Jurisdiction B and Jurisdiction E.

The Amount A Profit subject to tax in Jurisdiction B is 1000 and ABC plc pays tax of ($1000 * 25\% = 250$).

Jurisdiction C provides relief through a mechanism provided for in Article 12(1)(a) through (c) to Entity C with respect to the tax paid by the DPE in relation to Entity C's portion of the *Amount A relief amount*. The portion of the *Amount A relief amount* attributable to Entity C is calculated as $600 / 800$ (800 being the 1000 *Amount A relief amount* of the Covered Group less the 200 attributable to Jurisdiction E, a non-Party), being 75%. However, given Amount A Profit for which relief is attributable to a non-participating jurisdiction has been subject to tax, this tax should be excluded from the "tax paid by the Designated Payment Entity" component of the relieving obligation as it is not attributable to the *Amount A relief amount* allocated to a Party to the Convention. Therefore, the relief obligation for Jurisdiction C

applicable to Entity C is still in respect of 150 of tax paid by the DPE ($[(250 \times 800 / 1000)] \times 75\% = 150$), as during the transition period. The relief to be provided in relation to this 150 of tax is determined under the domestic law of Jurisdiction C (per Article 12(2)) and subject to the guardrails provided in Article 12(3) through (5).

In the case of Jurisdiction D, which provides relief through a mechanism provided for in Article 12(1)(a) through (c), the same adjusted tax paid figure is used, and the relief to be provided to Entity D is in relation to the 50 of tax paid by the DPE ($[(250 \times 800 / 1000)] \times (200 / 800) = 50$). Similarly, if Jurisdiction D provides relief via a deduction, the obligation to provide relief should be in respect of the *adjusted Amount A relief amount allocated to the relief entity* of 200. The actual relief to be provided in either circumstance is determined under the domestic law of Jurisdiction D.

Example 2 – Multiple market jurisdictions

ABC Group is a Covered Group for Amount A purposes. The UPE of the Group, ABC plc, is resident for tax purposes in Jurisdiction A, a Jurisdiction which has ratified the MLC. ABC plc has a Period of 1 January to 31 December for Amount A purposes. ABC plc is the Designated Payment Entity and *coordinating entity* for the Group.

ABC Group's has two market jurisdictions for Amount A purposes, Jurisdiction B and Jurisdiction F. ABC Group's *relieving jurisdictions* are Jurisdiction C, Jurisdiction D, Jurisdiction E. ABC plc directly owns 100% of the shares and voting rights in the following entities:

- Entity C in Jurisdiction C;
- Entity D in Jurisdiction D; and
- Entity E in Jurisdiction E.

Transition period (FY25)

ABC Group is in scope of the Amount A rules for the first time for the Period 1 January 2025 to 31 December 2025 (FY25). For FY25, Jurisdiction B, Jurisdiction C and Jurisdiction D have ratified the MLC. However, Jurisdiction E and Jurisdiction F have not ratified the MLC. Jurisdiction B and Jurisdiction E do not have an agreement for the avoidance of double taxation with respect to taxes on income with each other.

For FY25, ABC plc has Amount A Profit 2000, of which 1000 is attributable to Jurisdiction B and Jurisdiction F respectively. Amount A Profit is subject to tax at the rate of 25% in Jurisdiction B. Jurisdiction F is not a Party to the MLC, therefore it cannot tax Amount A Profit.

For FY25, Jurisdiction C, Jurisdiction D, and Jurisdiction E have *Amount A relief amounts* of 1200, 400, and 400 respectively. In the transition period, as provided for under Article 4(3), the Amount A Profit that Jurisdiction B is allowed to tax is adjusted to reflect the fact that a portion of the *Amount A relief amount* is borne by a non-participating jurisdiction (Jurisdiction E).

The amount of Amount A Profit taxable in Jurisdiction B is reduced by: $1000 \times (400 / 2000) = 200$. Therefore the Amount A Profit subject to tax in Jurisdiction B is $(1000 - 200 = 800)$. ABC plc pays tax of $(800 \times 25\% = 200)$ in Jurisdiction B on this Amount A Profit. No Amount A Profit is subject to tax in Jurisdiction F.

For the purpose of determining their relieving obligations for FY25, Jurisdiction C and Jurisdiction D need to determine the relevant portion of the *Amount A relief amount* of a Covered Group under Article 11 with respect to which it shall provide relief from double taxation to each *relief entity* identified under Article 13. Given Entity C and Entity D are the only Group Entities within the respective Jurisdictions, those entities are identified as *relief entities* under the domestic laws of Jurisdiction C and Jurisdiction D.

Jurisdiction C provides relief to Entity C with respect to the tax paid by the DPE in relation to its share of the *Amount A relief amount*. The portion of the *Amount A relief amount* attributable to Entity C is calculated as $1200 / 1600$ (1600 being the 2000 *Amount A relief amount* of the Covered Group less the 400 *Amount A relief amount* attributable to Jurisdiction E), being 75%. Therefore, the relief obligation for Jurisdiction C applicable to Entity C is in respect of 150 of tax paid by the DPE ($200 * 75\% = 150$). The relief to be provided in relation to this 150 of tax is determined under the domestic law of Jurisdiction C (per Article 12(2)) and subject to the guardrails provided in Article 12(3) through (5).

Similarly, for Jurisdiction D, it will apply the same adjustment in determining its relieving obligation in relation to Entity D. The portion of the *Amount A relief amount* attributable to Entity D is calculated as $400/1600$, being 25%. Therefore, the relief obligation for Jurisdiction D applicable to Entity D is in respect of 50 of tax paid by the DPE ($200 * 25\% = 50$). The relief to be provided in relation to this 50 of tax is determined under the domestic law of Jurisdiction D (per Article 12(2)) and subject to the guardrails provided in Article 12(3) through (5).

If Jurisdiction D provides relief via the mechanism in Article 12(1)(d) (a deduction), the obligation to provide relief should be in respect of the *adjusted Amount A relief amount allocated to the relief entity* of 200. This being $400 \times ([2000-1000]/2000)$. This reflects that an adjustment is required as there is Amount A Profit allocated under Article 5 to a Jurisdiction that is not a Party. The relief to be provided in relation to this is determined under the domestic law of Jurisdiction D and subject to the guardrails provided in Article 12(3) through (5).

Post transition period

After the expiration of the transition period provided under Article 4(3), ABC Group will need to consider whether adjustments will need to be made.

By the end of FY27, Jurisdiction E and Jurisdiction F have not ratified the MLC. Assume for FY27 that ABC Group has the same market jurisdiction, *relieving jurisdictions*, *relief entities* and allocations of Amount A Profit and *Amount A relief amount* as per FY25.

In this scenario, the Amount A Profit subject to tax in Jurisdiction B will not be adjusted to reflect the fact that a portion of the *Amount A relief amount* is borne by a non-participating jurisdiction (Jurisdiction E) as there is no agreement for the avoidance of double taxation with respect to taxes on income between Jurisdiction B and Jurisdiction E.

The Amount A Profit subject to tax in Jurisdiction B is 1000 and ABC plc pays tax of ($1000 * 25\% = 250$). No Amount A Profit is subject to tax in Jurisdiction F.

Jurisdiction C provides relief to Entity C with respect to the tax paid by the DPE in relation to its share of the *Amount A relief amount*. The portion of the *Amount A relief amount* attributable to Entity C is calculated as $1200 / 1600$ (being the 2000 *Amount A relief amount* of the Covered Group less the 400 attributable to Jurisdiction E), being 75%. However, given Amount A Profit for which relief is attributable to a non-participating jurisdiction has been subject to tax, this tax should be excluded from the "tax paid

by the Designated Payment Entity” component of the relieving obligation. Therefore, the relief obligation for Jurisdiction C applicable to Entity C is still in respect of 150 of tax paid by the DPE ($[(250 \times 1600/2000) \times 75\% = 150]$). The relief to be provided in relation to this 150 of tax is determined under the domestic law of Jurisdiction C (per Article 12(2)) and subject to the guardrails provided in Article 12(3) through (5).

In the case of Jurisdiction D, the same adjusted tax paid figure is used, and the relief to be provided to Entity D is in relation to the 50 of tax paid by the DPE ($[(250 \times 1600/2000) \times (400/1600) = 50]$). Similarly, the relief to be provided in relation to this amount of tax is determined under the domestic law of Jurisdiction D.

If Jurisdiction D provides relief via the mechanism in Article 12(1)(d) (a deduction), the obligation to provide relief should be in respect of the *adjusted Amount A relief amount allocated to the relief entity* of 200. This being $400 \times [(2000-1000)/2000]$. This reflects that an adjustment is required as there is Amount A Profit allocated under Article 5 to a Jurisdiction that is not a Party. The relief to be provided in relation to this is determined under the domestic law of Jurisdiction D and subject to the guardrails provided in Article 12(3) through (5).

Example 3 – Prior unallocated Amount A relief

In Year 1, a Covered Group has an aggregate *Amount A relief amount* of 2000 and the tax paid by the Designated Payment Entity to Parties under Article 4 is 250. Under Article 11, there is unallocated *Amount A relief* for the Covered Group of 200. In Year 2, the Covered Group has Amount A Profit of 2000 and tax paid by the Designated Payment Entity in Year 2 is also 250.

To the extent that relief is provided through a mechanism provided for in Article 12(1)(a) through (c), where a *relief entity* is not subject to Article 11(15):

- As 200 of the Amount A Profit is not allocated to any *relieving jurisdiction* in the Period for Year 1, “the tax paid by the Designated Payment Entity” with respect to the *Amount A relief amount* for Year 1 is reduced to 225 ($[1-(200/2000)] \times 250$).
- In Year 2, the 200 of *prior unallocated Amount A relief* from Year 1 is added to the Amount A Profit for Year 2 to form part of the *Amount A relief amount* calculated by reference to Year 2. Therefore, the amount of the reduction in the “tax paid by the Designated Payment Entity” component applied in Year 1 will be added to the “tax paid by Designated Entity” component in Year 2, increasing the amount to 275.

To the extent that relief is provided through under Article 12(1)(d), no adjustment is required as this occurs as a matter of course through the calculation of the *adjusted Amount A relief amount allocated to the relief entity*.

Where a relief entity is subject to Article 11(15) for the Period

In circumstances where a *relief entity* is subject to Article 11(15), where relief is provided through a mechanism provided for in Article 12(1)(a) through (c), due to Article 12(8) the “tax paid by the Designated Payment Entity” component should not include any tax paid in relation to *prior unallocated Amount A relief*, as the *Amount A relief amount* of such Jurisdictions excludes any amount of *prior unallocated Amount A relief*. Therefore, only the tax paid by the Designated Payment entity on Amount A Profit of Year 2 is relevant. As the tax paid component for Year 2 only includes tax in relation to Year 2 Amount A Profit, to determine the *relief entity’s* portion of this tax, the denominator in the ratio in

Article 12(7)(a)(ii) is reduced by the sum of any *prior unallocated Amount A relief* that forms part of the *Amount A relief amount* allocated to *relieving jurisdictions* that are Parties to the Convention.

Where relief is provided through a mechanism provided for in Article 12(1)(d), Article 12(8) provides an adjustment to the numerator and denominator of the ratio outlined in Article 12(7)(b). Both amounts should exclude any amount attributable to *prior unallocated Amount A relief*. Given the *Amount A relief amount* allocated to the *relief entity* should not include any amount attributable to *prior unallocated Amount A relief* (Article 12(7)(b)(i)), adjusting the ratio ensures that the *relieving jurisdiction* is not required to provide relief in relation to Amount A Profit subject to tax in a previous Year.

Paragraph 2

439. Paragraph 2 provides that a Party's obligation to provide relief in paragraph 1 is implemented under the conditions defined by its domestic law. Therefore, a Party may determine the requirements for eligibility for relief and the amount of relief provided under the methods described in paragraph 1 based on its domestic policy choices, subject to the guardrails provided in paragraphs 3 and 4. The requirements of paragraph 2 do not create an obligation on a Party to apply its current domestic law conditions in relation to double taxation relief consistently to double taxation relief under the Convention. That is, Parties are free to have specific domestic law provisions in relation to double taxation relief for the tax paid on the share of the *Amount A relief amount* in accordance with the Convention and those domestic law provisions may deviate from other provisions in domestic law that apply regarding double taxation relief of foreign taxes.

440. Paragraph 2 also makes the necessary connection between the tax paid by the Designated Payment Entity and the tax paid on the share of the *Amount A relief amount* that is allocated to the *relief entity* for which it is entitled to double taxation relief. This connection requires that in the domestic law of the Party, a *relief entity* is to be treated as if it paid part of the relevant tax paid by the Designated Payment Entity under Article 4.

441. Regarding eligibility for double taxation relief, this may include when a *relief entity* becomes entitled to access relief. For example, a Party may choose to give relief when foreign tax is accrued or alternatively only after payment of foreign tax. Further, a Party may require proof of payment or specific information be provided by a *relief entity* in order to process a valid claim of relief as part of its domestic processes.

442. The domestic law of a Party may determine how to calculate and / or limit the amount of relief provided or put in place specific requirements in relation to the utilisation of the relief attribute established in accordance with paragraph 1. This may include, but is not limited to:

- providing the amount of relief available based on the domestic tax rate of the Party. For example, relief may not exceed the domestic tax payable on the *Amount A relief amount* that has been subject to tax under Article 4 (recognising that part of the *Amount A relief amount* may not be subject to tax as the relevant Jurisdiction for which the Amount A Profit is allocated under Article 5 may not be a Party to the Convention or due to a reduction in Amount A Profit subject to tax under Article 4(2)) multiplied by the corporate tax rate of the Party. However, where the *Amount A relief amount*, or equivalent income or profit, is subject to an alternative income tax regime (for example, Tonnage Tax), relief may be limited on the basis of the tax applicable to such income or profit;

- providing the amount of relief based on a blended domestic tax rate or at different tax rates, where the income of a *relief entity* is subject to multiple tax rates or taxed under an alternative income tax regime. For example, the effective corporate tax rate where part or all of the *relief entity's* income is subject to concessional taxation in the Party, such as income derived from a concessional tax regime; or
- limiting the amount of relief by reference to the proportion of the *Amount A relief amount* that has been subject to tax in a Party by virtue of Article 4 over the Elimination Profit (or Loss); or
- putting in place specific requirements for the utilisation of tax credits and carry-forward credits in relation to relief provided.

443. However, in determining the amount of relief provided under paragraph 1 and the conditions to utilise such relief, Parties will need to ensure their domestic laws do not infringe on the guardrails provided in paragraphs 3 and 4.

Paragraphs 3 and 4

444. Paragraphs 3 and 4 contain the guardrails applied to a Party, in relation to the provision of relief. These guardrails are primarily concerned with ensuring that Parties take into account potential temporary differences between the Elimination Profit (or Loss) and the domestic tax base in determining the amount of any relief attribute provided in accordance with paragraph 1. These guardrails may also limit the effect of the provision of double taxation relief for Amount A in a fiscal year that does not align with the Period of the Covered Group. However, these guardrails are not intended to limit the domestic policy decisions of Parties in relation to the provision of relief under the Convention, other than as expressly stated.

445. Under paragraph 3, where a Party provides relief in accordance with paragraph 1(a) or (b) in determining the amount of payment or refundable tax credit provided under its domestic law, a Party shall not be allowed to directly limit the amount of relief by direct reference to the domestic tax actually paid by the *relief entity* to a Party in a fiscal year. In the case of paragraph 1(b), this means a Jurisdiction cannot effectively cap the amount of the credit at the domestic tax payable by the *relief entity* before the credit is provided. To allow for such capping would not allow for any temporary differences to be taken into account.

446. Under paragraph 4, where a Party provides relief through either a non-refundable tax credit (paragraph 1(c)) or a deduction (paragraph 1(d)), the Party will be required to allow a *relief entity* to carry-forward any unutilised amount of the non-refundable tax credit or deduction for a minimum of three fiscal years, and the calculation of the non-refundable tax credit or deduction cannot be limited to ensure there is never an amount to which carry-forward could apply.

447. Under paragraph 4(a), a Party implementing a method described in paragraph 1(c) or (d) in its domestic law must ensure the calculation of the amount of non-refundable credit or deduction allows for the prospect of an excess amount to be generated in circumstances where there is insufficient tax paid by a *relief entity* in the fiscal period. This requirement is similar to the guardrail in paragraph 3, that a Party cannot limit relief directly by the tax payable by the *relief entity* in the fiscal year. This exclusion is required as without it, the carry-forward requirement in paragraph 4(b) could be effectively nullified if the relief entitlement were limited to the income tax actually paid in the fiscal period in which relief was given. If this was the case, there would be no relief amount available to be carried-forward and Parties would not be required to take into account temporary differences between the Elimination Profit (or Loss) and the domestic tax base. However, this requirement applies strictly to the calculation of the amount of the relief attribute under paragraph 1. For relief given in accordance with paragraphs 1(c) and (d), it does not require

a Party to give relief in any given year in excess of the domestic tax payable if the Convention did not apply. It merely requires that to the extent the relief attribute exceeds the domestic tax payable by the *relief entity* in the year that relief is given, the excess be carried forward for utilisation in a future fiscal year, in accordance with paragraph 4(b). As noted in paragraph 2, Parties are not restricted in their domestic policy decisions in relation to when any carry-forward credit can be utilised in a future fiscal year.

448. For purposes of paragraph 4(b) tax credits and deductions will be considered unutilised if there is insufficient income subject to tax in a Party for the relevant fiscal year to allow for the entire relief attribute (credit or deduction) to be utilised by the *relief entity*. However, this is a minimum requirement and parties are permitted to adopt more favourable relief utilisation policies (for example, carry-back and/or longer carry-forward periods). However, a carry-forward of any excess for at least three fiscal years is the minimum requirement under the Convention.

449. Paragraphs 3 and 4 are not intended to limit or restrict the domestic policy decisions of Parties in relation to the interaction of double taxation relief for Amount A and other tax credits available within a Party. For example, a Party will not be required to carry-forward any amount of relief provided under paragraphs 1(c) or (d) to the extent that it chooses to apply such relief before any other domestic tax credit available in its domestic law. Where this is the case, the Party is not required under the Convention to carry-forward any other unutilised non-refundable tax credit on the basis that the relief provided in accordance with paragraph 1 leaves insufficient capacity for those other non-refundable tax credits to be utilised. The prioritisation of the application of any carry-forward attribute, including those required under the Convention, is a matter for the domestic law of each Party.

Paragraph 5

450. Paragraph 5 provides the timeframe for Parties to provide relief in accordance with paragraph 1. Parties may choose to provide relief in either:

- a) the fiscal year of the *relief entity* that includes the last day of the Period for which the tax liability of the Designated Payment Entity is calculated; or
- b) the fiscal year that includes the date that is 18 months after the end of the Period.

451. Parties may also choose to adopt both mechanisms. However, to the extent that either or both mechanisms are adopted, the implementation of each is subject to the conditions outlined in subparagraphs (a) and (b).

Subparagraph (a)

452. Where a Party chooses to apply subparagraph (a), this will most likely require the amendment of the income tax return of the *relief entity* in order to give effect to double taxation relief. That is, a *relief entity* will need to amend an already filed income tax return to include the relief claim, of which the Party would then issue a refund of the relief in accordance with its domestic law. However, a Party will be required to provide relief to the *relief entity* within 90 days of receiving a valid claim for relief. This requirement also applies in circumstances where relief is provided under paragraph 1(a), even though the *relief entity* may not have an income tax year relevant to the Jurisdiction. For example, when the *relieving jurisdiction* elects the option allowed by Article 13(5), relief may be provided directly to the Designated Payment Entity rather than to a Group Entity that is a tax resident or has a Taxable Presence in the Party.

453. A “valid claim for relief” is any application or amendment request that meets all the domestic law requirements stipulated by the Party. Parties are free to determine in their domestic law the necessary

information requirements required for such a claim. Upon receipt of a valid claim for relief, a Party would be required to provide relief within 90 days. However, the prescribed period of 90 days is not considered to commence until all the necessary requirements stipulated in the domestic law of the Party has been provided.

454. Further, a Party may also allow for a *relief entity* to file an application or amendment request prior to the domestic law requirements being met. This would be the case where a Party allows for the submission of an application or amendment request to a tax return prior to any tax being paid by the Designated Payment Entity to other Parties in order to initiate the relief process, but the domestic law entitlement to double taxation relief requires the Designated Payment Entity to have actually paid tax. Parties may put in place such processes to increase the timeliness of the provision of double taxation relief. Where this occurs, the “claim for relief” will be considered “valid” at the time the Designated Payment Entity pays the tax, rather than the filing date of the application or amendment request.

455. Upon receipt of a valid claim for relief a Party will have 90 days to provide relief, unless the Party opens an audit in relation to the relief claimed. If an audit is opened on the relief claim the prescribed time limit would no longer apply. Auditing a relief claim may also include the Party auditing other elements of the relevant tax return, as these elements may have an effect on the amount of relief provided by the Party for the fiscal period. However, this requirement does not preclude a Party from auditing the relevant fiscal period and the relief claim at a date after relief has been given.

456. The date when relief is considered to be provided is when a *relief entity* gains the cash-flow benefit of relief. This is when a refund is paid to the *relief entity*, or the amount is credited to the *relief entity*'s running balance account. A running balance account is the summary of indebtedness to or from the tax administration by a taxpayer. Many Jurisdictions use such accounts as it allows for taxpayers to meet their respective tax obligations (including VAT and other taxes) through a single payment stream and refunds can be used to offset liabilities. Therefore, crediting against such an account is akin to providing a cash payment as the *relief entity* can immediately use the amount to offset other liabilities (including instalment payments). This also means Parties will not be considered to have breached their obligation in accordance with subparagraph (a) where the relief provided is offset against another pre-existing liability of the *relief entity* rather than resulting in a payment.

Subparagraph (b)

457. Parties may also choose to provide relief without requiring the amendment of the income tax return referable to the fiscal period of the Covered Group. Generally, this would mean that a Party would give relief in the fiscal year that includes the date that is 18 months after the end of the Period – which is when payments made by the Designated Payment Entity in relation to tax under Article 4 become due.

458. Where this is the case, a Party shall allow for relief to be provided through the domestic tax procedures of that Party, without the need to amend previous fiscal year tax returns. *Relief entities* should be able to claim relief through their domestic tax returns in the *relieving jurisdiction*. As part of that domestic tax return procedure, Parties would be free to require any additional information considered necessary. However, the provision of relief under subparagraph (b) is only allowed in circumstances where a Party has in place a regime requiring payment toward an expected liability in instalments or an interim tax filing during a fiscal year, to provide the cash-flow benefit of relief to a *relief entity* prior to the lodgement of the tax return for the relevant income tax year the relief is provided.

459. This requirement is to ensure an appropriate and timely outcome where relief is provided without the amendment of the income tax return referable to the fiscal period. Where a Party chooses to provide relief in accordance with paragraph 1(b) through (d), it shall be required to allow for a *relief entity* to make

a downward adjustment toward an expected liability in instalments or an interim tax return during a fiscal year. This is to ensure that the cash-flow benefit of relief is provided to the *relief entity* at the next earliest possible time. Such an adjustment is only required to instalment payments after a *relief entity* becomes entitled to relief under the domestic law of the Party. For example, a Party may require that foreign tax be paid (rather than accrued) in order for a *relief entity* to be entitled to relief. Therefore, the Party would be required to allow the *relief entity* to reduce its next instalment after the Designated Payment Entity actually pays tax in relation to its obligations under Article 4.

460. It is noted that the requirement to provide relief at the earliest payment after a *relief entity* become eligible does not necessarily mean that the cash-flow benefit provided fixes the amount of the relief entitlement of the *relief entity*. As paragraph 2 allows for the calculation of relief to be subject to domestic law, any downward adjustment to an instalment payment or interim tax liability during a *relief entity's* tax year that is based on an estimate of entity's expected tax liability (i.e. instalment payment or interim liability) may be subject to an adjustment as part of the lodgement of the end of year tax return. It is also noted that where relief cannot be exhausted in a fiscal year due to a deficit of instalment payments or interim liability, or due to the timing of the instalment payment or interim tax filing, the Party is required to make an adjustment as part of the lodgement of the end of year tax return.

Paragraph 6

461. Paragraph 6 provides for the deeming rules to ensure that relief can be provided in circumstances where a *relief entity* or a *local entity* satisfies the Designated Payment Entity's obligation to pay tax in a Party due to the liability under Article 17. Where a *relief entity* or a *local entity* meets an obligation of the Designated Payment Entity in accordance with Article 17, relief will be available to the *relief entity* as if the Designated Payment Entity has met its obligation.

Paragraph 7

462. Paragraph 7 defines the terms "relevant portion of the tax paid by the Designated Payment Entity" and "adjusted Amount A relief amount allocated to the relief entity" for purposes of paragraph 1 to ensure the appropriate outcomes in situations where Amount A Profit or *Amount A relief amounts* are attributed to Jurisdictions that are not Parties to the Convention.

463. Paragraph 7(a) applies in circumstances where a Party provides double taxation relief to a *relief entity* via a direct payment, refundable tax credit or non-refundable tax credit. Where this is the case, the "relevant portion of the tax paid by the Designated Payment Entity" that is attributable to each *relief entity's Amount A relief amount* (allocated under Article 13) is defined by reference to the ratio in paragraph 7(a) which proportionately allocates the tax paid on *Amount A relief amounts* attributable to Parties to the Convention. That is, the formula aims to remove any tax paid by the Designated Payment Entity from the calculation that is attributable to a *relieving jurisdiction* that is not a Party to the Convention, from the portion attributable to the *relief entity's Amount A relief amount*. In effect, this ensures that *relieving jurisdictions* do not have an obligation to relieve tax paid by the Designated Payment Entity that is attributable to non-Party *relieving jurisdictions* in circumstances where the full amount of Amount A Profit is still subject to tax in a Party due to the fact that Article 4(2) does not apply to reduce the Amount A Profit available for taxation by the *Amount A relief amount* allocated to the non-Party *relieving jurisdiction*. This will apply in circumstances where, after the 2-year transition period, a *relieving jurisdiction* is not a Party to the Convention and does not have agreement for the avoidance of double taxation with respect to taxes on income (whether or not other taxes are also covered) in force with the Party that is allocated the taxing right to Amount A Profit under Article 5.

464. Paragraph 7(b) applies in circumstances where double taxation relief is provided via a deduction. As the relieving obligation under paragraph 1(d) is undertaken by reference to the *Amount A relief amount* rather than tax paid, the "adjusted Amount A relief amount allocated to the relief entity" in paragraph 7(b) is the *relief entity's Amount A relief amount* reduced on a proportionate basis to take into account Amount A Profit that is allocated to a non-Party under Article 5, but because the Jurisdiction is not a Party, the amount is not subject to tax under Article 4. Therefore, the "adjusted Amount A relief amount allocated to the relief entity" will ensure an appropriately lower relief entitlement in situations where Amount A Profit is allocated to a non-Party and therefore not subject to tax under the Convention.

465. Both paragraph 7(a) and (b) are relevant, respectively, for determining the portion of the Group's taxation and adjusted *Amount A relief amount* under the Convention allocated to each *relieving jurisdiction*. Regardless, the amount of relief provided by each *relieving jurisdiction* is subject to paragraph 2, and as such the domestic law of the *relieving jurisdiction* subject to the requirements outlined in Article 12(3) through (5).

466. In addition, paragraph 7(c) aligns the meaning of the term "relief entity" for purposes of Article 12 with meaning of "relief entity" as outlined in Article 13(12)(a).

Paragraph 8

467. In circumstances covered by Article 11(15), where a *relief entity* is in a *relieving jurisdiction* that was not a Party in the previous Period, paragraph 8 excludes any amount of *prior unallocated Amount A relief* from the *Amount A relief amount* of the Covered Group. In effect, the result is that for such *relief entities* (all *relief entities* in a Jurisdiction to which Article 11(15) is applicable for the Period), the relief obligation of the *relieving jurisdiction* is determined solely on the basis of the Amount A Profit subject to tax under Article 4 in the Period. This ensures that the relieving obligation of such *relieving jurisdictions* does not include an obligation to provide relief for tax on Amount A Profit in a Period in which the *relieving jurisdiction* was not a Party.

468. Where relief is provided through a mechanism provided for in Article 12(1)(a) through (c), the "tax paid by the Designated Payment Entity" component should not include any tax paid in relation to *prior unallocated Amount A relief*, as the *Amount A relief amount* of such Jurisdictions excludes any amount of *prior unallocated Amount A relief* and the denominator in the ratio in Article 12(7)(a)(ii) is reduced by the sum of any *prior unallocated Amount A relief* that forms part of the Amount A relief allocated to *relieving jurisdictions* that are Parties to the Convention.

469. Where relief is provided through a mechanism provided for in Article 12(1)(d), both the numerator and denominator of the ratio outlined in Article 12(7)(b) should exclude any amount attributable to *prior unallocated Amount A relief*.

470. The intended outcome of paragraph 8 is illustrated in Example 3 above.

Article 13 – Identification of relief entities entitled to elimination of double taxation

471. Article 13 provides how a Party that is a *relieving jurisdiction* under Article 11 is required to identify those Group Entities which are entitled to double taxation relief in accordance with Article 12 in relation to payments made by the Designated Payment Entity to market jurisdictions.

472. In addition, Article 13 also deals with the treatment of compensation payments from *relief entities* to the Designated Payment Entity, and where applicable from the Designated Payment Entity to a *local entity*. These compensation payments are required to ensure that the Designated Payment Entity is adequately funded by *relief entities* to meet its required payment obligations under the Convention.

473. The requirements under Article 13 are not intended to compel a Party to treat Group Entities separately in circumstances where those Group Entities are treated as a single taxpayer for income tax purposes in the domestic law of the Party, e.g. in domestic tax consolidation tax regimes. In such circumstances, a Party shall meet its obligations under Articles 12 and 13 through the calculation and provision of double taxation relief on a consolidated basis.

Paragraph 1

474. Paragraph 1 outlines the default method as to how a Party that is a *relieving jurisdiction* under Article 11 is required to identify those *relief entities* which are eligible for double taxation relief in that Party.

475. “*Relief entity*” is defined in subparagraph (a) and includes any Group Entity of a Covered Group identified under paragraphs 1 through 5. This includes a Taxable Presence of a non-resident Group Entity in the *relieving jurisdiction*.

476. Further, an incorporated Joint Venture to which Annex B Section 4(14) applies in relation to a Covered Group may also be considered a “*relief entity*” notwithstanding it is not a Group Entity of a Covered Group. This is to ensure that the modifications for incorporated Joint Ventures in Annex B Sections 4 and 5 apply appropriately. Therefore, for purposes of Article 13, such incorporated Joint Ventures are to be included within the meaning of “Group Entity”. Without such a modification, it may be the case that a *relieving jurisdiction* is identified in which no Group Entity has a tax liability and therefore may result in no double taxation relief being provided.

477. As a default, a Party will be required to identify *relief entities* on the basis of the following amounts for a Period:

- a) *excess profit*;
- b) *taxable profit*; or
- c) *accounting profit*.

478. All of the above metrics provide a direct or close proxy in determining which relief entities derive the residual profits of a Covered Group. A Party will be free to choose between any of the abovementioned available metrics. It is expected that Parties will adopt a consistent approach to choosing between the metrics.

479. The definition of “excess profit” depends on whether the *relief entity* is a tax resident of the *relieving jurisdiction* or has a Taxable Presence in the *relieving jurisdiction*. However, conceptually the *excess profit* is the Elimination Profit (or Loss) of the entity or Taxable Presence, reduced by the product of the entity’s (or Taxable Presence’s) Elimination Threshold Return on Depreciation and Payroll multiplied by its depreciation and payroll.

480. “Taxable profit” is the profit liable to income tax under the domestic law of the Party for the Period. This should be easily determined through the domestic tax returns of Group Entities.

481. Lastly, “accounting profit” is the profit reflected in the financial statements prepared under an Acceptable Financial Accounting Standard. In circumstances where a Group Entity does not prepare audited financial statements, it will not be required to prepare such financial statements. Its calculation of *accounting profit* for purposes of Article 13 may merely be determined in accordance with an Acceptable Financial Accounting Standard. A Taxable Presence may not have separate financial accounts. Therefore, its *accounting profit* may be determined by the domestic laws of the Party. However, a Party could provide that the determination of the *accounting profit* of a Taxable Presence is determined in accordance with Annex B Section 4(3), or on the basis of what would have been reflected in the separate financial accounts determined in accordance with an Acceptable Financial Accounting Standard of the Taxable Presence, if they existed.

Paragraphs 2 through 4

482. Paragraphs 2 through 4 describe the “waterfall” approach a Party must take in allocating the right to double taxation relief. The reason for the “waterfall” approach is to limit the amount of Group Entities that need to be provided with double taxation relief.

483. A Party will be required to allocate the right to double taxation relief through first assigning relief to the Group Entity with the highest amount of profit under the chosen metric in paragraph 1. Relief will be allocated to that Group Entity until its “profit” is equalised to the Group Entity with the second highest “profit”. The process will then continue until the entirety of the right to relief for that Party has been exhausted.

484. For example, assume a Party under Article 11 is required to relieve 800 (i.e. the Party’s *Amount A relief amount* is 800). The Party has chosen “excess profit” as its relevant metric. There are eleven Group Entities in the Party, with the following characteristics:

- 1 entity (Entity 1) has *excess profit* of 800.
- 2 entities (Entity 2 and Entity 3) have *excess profit* of 300 each.
- 5 entities have *excess profit* of 25 each.
- 3 entities have *excess profit* of nil.

In accordance with paragraphs 2 through 4, the Party would allocate relief on the following basis:

- The Party would first allocate 500 of relief to Entity 1.
- The Party would then allocate 100 of relief to the Entity 1, and Entity 2 and Entity 3 (i.e. those with *excess profit* of 300).
- Therefore, Entity 1 would have an *Amount A relief amount* of 600 and Entity 2 and Entity 3 would have an *Amount A relief amount* of 100 respectively.

485. It is not intended that paragraphs 2 through 4 treat Group Entities separately in situations where a Party treats such entities as a single taxpayer. Where this is the case, the Party shall modify the application of the “waterfall” to ensure that those Group Entities that are treated as a single taxpayer for income tax purposes in the domestic law of the Party are treated as a single entity for allocation under the “waterfall”. The Party shall also be required to calculate relief provided under Article 12 on a similar basis.

Paragraph 5

486. Paragraph 5 permits a Party to use any other method to allocate the entitlement to relief from double taxation among Group Entities than those prescribed in paragraph 1. This may include additional metrics in the domestic law of the Party, or the discretion to agree a different metric between the tax administration and the relevant entities of the Covered Group in the Party.

487. However, the use of a metric other than those prescribed in paragraph 1 is only allowed in circumstances where the tax administration and all the *relief entities* that would be identified under paragraphs 2 through 4 and the entity or entities that will be eligible for relief under the agreed metric, consent to the use of a different method of allocating the entitlement to relief from double taxation. Further, Parties are required to put in place measures to give effect to this flexibility only to the extent permitted by their domestic law.

488. This flexibility is intended to allow tax administrations and Covered Groups to agree to an alternative metric, including the provision of relief to a single taxpayer or to the Designated Payment Entity directly. In ensuring consent of the *relief entities*, Group Entities relevant to a Party may give authority to a single Group Entity to consent on behalf of the *relief entities*. Further, such an election or agreement to use a different allocation metric shall not be considered irrevocable by either *relief entities* identified under paragraphs 2 through 4 or the Party.

Paragraphs 6 through 12

489. Paragraphs 6 through 9 and paragraph 11 give effect to the “compensation payments” made by *relief entities* to the Designated Payment Entity. This reflects three things:

- The Designated Payment Entity is making payments to Parties in accordance with Article 4 economically on behalf of *relief entities*. As such, *relief entities* are entitled to double taxation relief under Article 12 in relation to payments made by the Designated Payment Entity in accordance with Article 4.
- *Relief entities* are required to make such compensation payments to the Designated Payment Entity in order to fund their proportion of the liability of the Designated Payment Entity to market jurisdictions.
- Parties are given the option to allow for Covered Groups to reduce the compensation payment required to be made between a *relief entity* and a Designated Payment Entity in order to access double tax relief. However, this requirement is not mandatory for Parties to include in their domestic law.

490. Where a *relief entity* pays a liability of the Designated Payment Entity in accordance with Article 17, it is not obliged to make a compensation payment to the Designated Payment Entity. In the event the *relief entity* makes such a payment, paragraph 6 specifies that any compensation payment made to the Designated Payment Entity will not be disregarded for tax purposes and will be subject to the domestic tax laws of the Parties. This is to ensure that payments cannot be made to the Designated Payment Entity and/or *local entities* without any tax consequences to the extent that a *relief entity* has paid a liability for the Period under Article 17.

491. Paragraph 7 requires that a Party shall not be obligated to provide double taxation relief to a *relief entity* unless such compensation payments have been made. However, in circumstances where Article 17 applies, to the extent the *relief entity* pays the taxing Jurisdiction, releasing the Designated Payment Entity

of its obligation, there is no obligation on the *relief entity* to make a compensation payment to the Designated Payment Entity for the amounts paid by the *relief entity* and the Party shall be obliged to provide double taxation relief to the *relief entity* pursuant to Article 12.

492. In determining the amount of the compensation payment required to be made by a *relief entity* to a Designated Payment Entity, paragraph 7 requires that the payment should be equal to the *Amount A compensation payment limit*, i.e. equal to the *relief entity's* proportion of the tax liability of the Designated Payment Entity to all Parties in accordance with Article 4. This is determined by multiplying the tax liability of the Designated Payment Entity to all Parties for the Period by the proportion of the Covered Group's *Amount A relief amount* allocated to the *relief entity*. However, in accordance with paragraph 11, a Party may, in its domestic law, allow for a *relief entity* and the Designated Payment Entity to agree to lower the amount of compensation payment. Where this is the case, the *Amount A compensation payment limit* is reduced to the agreed amount (which can be zero).

493. Paragraph 8 requires a Party to effectively restrict the amount of the compensation payment to the amount of tax paid by the Designated Payment Entity on the *Amount A relief amount* allocated to the *relief entity*. This is referred to as the "Amount A compensation payment limit". This ensures that any tax exemption only applies to the extent of the amount the *relief entity* would have been liable to in a market jurisdiction if it was the legally obliged taxpayer. Where the *Amount A relief amount* allocated to a *relief entity* also includes any "prior unallocated Amount A relief", any tax paid by the Designated Payment Entity under Article 4 in the prior Period in respect of the *prior unallocated Amount A relief* should also be included for the purpose of determining the *Amount A compensation payment limit*. Conversely, where under Article 12, there is unallocated Amount A relief for a Period, the tax paid by the Designated Payment Entity under Article 4 for that Period in respect of the unallocated Amount A relief should be excluded for the purpose of determining the *Amount A compensation payment limit*.

494. Under paragraph 9, the amount of the compensation payment shall be disregarded by the Parties for all income tax purposes and for the purpose of calculating the *entity elimination profit (or loss)* and *taxable presence elimination profit (or loss)*. This means that for a *relieving jurisdiction*, a compensation payment shall not be deductible, and the compensation payment should not be subject to tax in the hands of the Designated Payment Entity. This prohibition also extends to other tax items, including Value Added Taxes, customs, remittance taxes and withholding taxes. Further, compensation payments should not distort the outcomes for determining the Elimination Profit (or Loss) of Group Entities in future Periods.

495. However, compensation payments will only be disregarded if those payments are made from a *relief entity* to the Designated Payment Entity. This includes circumstances where a *relief entity* is determined under a metric in accordance with paragraph 5. That is, the obligation to provide a compensation payment is determined by the entity that is entitled to double taxation relief under paragraphs 1 through 5. Further, the exemption from taxation for compensation payments only applies in circumstances where the Designated Payment Entity or *local entity* pays the tax to Parties and not in circumstances where the relevant liability is met by a *relief entity* in accordance with Article 17. Where a *local entity* pays an obligation of the Designated Payment Entity in accordance with Article 17, the compensation payment from the *relief entity* to the Designated Payment Entity is disregarded from taxation only where a compensation payment is made from the Designated Payment Entity to the *local entity* (to the extent the compensation payment is equal to the liability paid by the *local entity* in accordance with Article 17 for the Period). Where this applies, paragraph 9(b) disregards the compensation payment from the Designated Payment Entity to the *local entity* for tax purposes and for the purpose of calculating the *entity elimination profit (or loss)* and *taxable presence elimination profit (or loss)*.

496. Paragraph 10 specifies that a Party shall ensure that Covered Groups are not restricted in being able to put in place arrangements that allow for *relief entities* to make compensation payments to the

Designated Payment Entity (and where applicable from the Designated Payment Entity to a *local entity*). This assessment will need to be undertaken individually by each Jurisdiction. However, no express measures are required under paragraph 10 where the domestic laws of a Jurisdiction do not restrict Covered Groups from putting in place the required arrangements to make compensation payments.

497. Where, the domestic law of a Party directly or indirectly prohibits the ability of a Covered Group to put in place arrangements for compensation payments under the Convention, the Party will be required to remove such limitations or put in place specific measures to ensure that such payments can be undertaken. When such measures are necessary to allow for compensation payments to be made, the Parties will have discretion in relation to what measures they adopt to allow for compensation payments to be made in accordance with the Convention. This may include specifying a direct legal obligation for an entity to make such a payment, or imposing a surcharge on an entity that does not make such a payment to commercially compel entities to make such payments.

498. Paragraph 11 allows for a Party, if it chooses, to allow for Groups to reduce the compensation payment required to be made by *relief entities* to the Designated Payment Entity in order to satisfy requirements of paragraph 7. In situations where the *relief entity* and the Designated Payment Entity contractually agree, as part of a *Covered Group's Amount A funding agreement*, *relief entities* will be entitled to relief on the condition it makes a compensation payment of the agreed amount in the *Covered Group's Amount A funding agreement*. However, the agreed amount cannot exceed the tax paid by the Designated Payment Entity with respect to the share of the *Amount A relief amount* that is allocated to the *relief entity* under Article 13. Further, where the *relief entity* and the Designated Payment Entity agree to a lower compensation payment, the payment will only be eligible to be disregarded to the extent the payment does not exceed the legal obligation contained in the *Covered Group's Amount A funding agreement*. Where a lower amount is agreed, the agreed lower amount will be the relevant amount of the *Amount A compensation payment limit* for the purpose of applying paragraphs 7 through 10.

499. Paragraph 11 is not mandatory for Parties to the Convention to implement in their domestic law. However, to the extent that a Party to the Convention that is a *relieving jurisdiction* does choose to implement such flexibility, other Parties to the Convention must accommodate the policy choice in their domestic law. That is, a *relieving jurisdiction* may allow for *relief entities* in its Jurisdiction to vary the required amount of an Amount A compensation payment to the Designated Payment Entity, in order to be entitled to double tax relief. The Party for which the Designated Payment Entity is a resident must, for purposes of paragraph 9, disregard for all income tax purposes, the amount of the compensation payment from a *relief entity* to the Designated Payment Entity, notwithstanding that the Party does not give such flexibility in its domestic law to *relief entities* in its own Jurisdiction.

500. Paragraph 12 contains the definitions used in the Article.

Paragraph 13

501. As the term "*relief entity*" in paragraph 12(a) includes incorporated Joint Ventures to which Annex B Section 4(14) applies in relation to a Covered Group, paragraph 13 specifically ensures that the relevant metric chosen by a Party to identify *relief entities* only takes into account the relevant share of the Covered Group's interest in the incorporated Joint Venture. That is, in circumstances where an incorporated Joint Venture operates in a *relieving jurisdiction*, for purposes of identifying whether it is a *relief entity* and any *Amount A relief amount* allocated to it, only the portion of the Covered Group's interest is relevant. For example, assume a Covered Group has a 25% interest in an incorporated Joint Venture and the relevant *relieving jurisdiction* has chosen to use *taxable profit* as the relevant metric. Only 25% of the *taxable profit* of the incorporated Joint Venture is relevant for the purpose of applying the waterfall outlined in paragraphs 2 through 4.

Part V – Administration and certainty

Section 1 – Administration

Article 14 – Filing requirements

502. Article 14 provides a uniform and harmonised approach to the filing of the relevant information in relation to the calculation of Amount A Profit and the amount of double taxation relief available for a Covered Group and the relevant Group Entities. In order for tax administrations to assess the tax due or relief to be granted in relation to Amount A, a Covered Group will be required to submit the Amount A Tax Return and Common Documentation Package to the relevant tax administration.

Paragraph 1

503. Paragraph 1 establishes that Parties shall allow Covered Groups between 9 and 12 months from the end of a Period to file an Amount A Tax Return and Common Documentation Package. The primary obligation to provide the Amount A Tax Return and Common Documentation Package to a tax administration falls on entities that are subject to the Act (i.e. the Designated Payment Entity and entities eligible for double taxation relief).

504. Paragraph 1 does not preclude all Parties from agreeing a standardised single filing date at a future date (e.g. as part of the Inclusive Framework's development of Model Rules, via the Conference of the Parties, or via a multilateral competent authority agreement). However, paragraph 1 does establish guardrails as to the limits of that discussion and any single agreed filing date would need to be between nine and twelve months from the end of a Covered Group's Period.

Paragraph 2

505. Subparagraph (a) provides that where an Amount A Tax Return and Common Documentation Package is filed by the time prescribed by the Party of the *lead tax administration*, Parties to the Convention will deem the filing obligation of the Covered Group met. This means that all Group Entities that are required to file an Amount A Tax Return and Common Documentation Package for a Period, will be deemed to have met their filing requirement within the prescribed time limit for all Parties, in circumstances where the Amount A Tax Return and Common Documentation Package is filed by the time prescribed by the Party of the *lead tax administration*. Subparagraph (b) notes that where an Amount A Tax Return and Common Documentation Package is not filed by the time prescribed by the Party of the *lead tax administration*, a Party to the Convention will deem any Group Entity's filing obligation met on the date the Amount A Tax Return and Common Documentation Package is filed with the *lead tax administration*.

Article 15 – The Amount A Tax Return and the Common Documentation

Paragraph 1

506. Article 15 sets out the content of the Amount A Tax Return and Common Documentation Package. The Amount A Tax Return and Common Documentation Package will enable tax administrations of Parties to assess the tax due under Article 4 or assist in the determining of the relief to be provided to *relief entities* of the Covered Group.

Paragraph 2

507. Paragraph 2 provides that the Conference of the Parties shall develop a standard template for the Amount A Tax Return and Common Documentation Package. This template will be agreed by the Conference of the Parties after the signing of the Convention.

508. The Amount A Tax Return and Common Documentation Package will include, but is not limited to, revenue and profit numbers of the Covered Group as well as relevant adjustments, on a Group level and if applicable, on a segmented level.

509. In addition, Covered Groups will need to provide revenue sourcing figures for each Jurisdiction, support their application of losses and the *marketing and distribution profits safe harbour adjustment* and provide the calculations underpinning the application of the elimination of double taxation relief rules (including adjustments in accordance with Article 18), as well as for the application of the exclusions for extractives and regulated financial services.

510. The Amount A Tax Return and Common Documentation Package will contain the relevant information to show how the liabilities under Article 4 are determined and provide the relevant calculations in determining the *Amount A relief amount* for Jurisdictions subject to Articles 11 through 13.

511. The Amount A Tax Return and Common Documentation Package will also be used to provide the Covered Group's request for an *advance certainty review*, or a *comprehensive certainty review* for the Period.

Article 16 – Streamlined compliance

512. Article 16 defines the conditions for the Designated Payment Entity to benefit from streamlined compliance in relation to liabilities under Article 4. The intention of the Article is that, where the Designated Payment Entity has filed an Amount A Tax Return and Common Documentation Package (centrally with the *lead tax administration*), it should not be subject to further income tax filing obligations in a Party, unless the Designated Payment Entity has a Taxable Presence in the Party other than that subject to tax under Article 4.

513. The aim of the streamlined compliance for Amount A is to enable Covered Groups to meet the relevant tax filing obligations in market jurisdictions through the Amount A Tax Return and Common Documentation Package and align the timing of payment obligations.

Paragraph 1

514. Paragraph 1 outlines the streamlined compliance treatment that Parties will apply to the Designated Payment Entity in relation to liabilities under Article 4. The rules outlined in paragraph 2 have no effect on the obligations of any other Group Entity subject to tax in the Party.

515. Subparagraph (a) details that where a Covered Group's Amount A Tax Return and Common Documentation Package has been filed, either in the market jurisdiction or with the *lead tax administration*, a Party shall deem the Designated Payment Entity to have met its income tax filing obligations (or if Amount A is separately taxed, filing obligations in relation to Amount A) in that Party for the Period. This provision requires a Party to effectively turn off the requirements for the lodgement of a local income tax return and any other income tax filing requirements triggered by having income liable to tax in the Party for the Designated Payment Entity (for instance, lodgement of financial reports). However, this does not affect the obligations of any other entity in the Covered Group that may have filing obligations in the Party.

516. Subparagraph (b) lists the information required for a Party to be able to register the Designated Payment Entity for tax purposes. The subparagraph overrides any domestic requirements in the Party typically required for registration.

517. Subparagraph (c) requires a Party to align the domestic fiscal year of the Designated Payment Entity with the Period of the Covered Group.

518. Subparagraph (d) requires a Party to provide that any profit subject to tax in accordance with Article 4 is deemed to be derived for income tax purposes in the domestic law of the Party on the last day of the Period. Similar to subparagraph (b), the intent of this subparagraph is for Parties to reduce the need for Covered Groups to have different filing and payment dates in multiple Parties in which they have no activities. The subparagraph also intends to align the dates from which any administrative penalties for late or non-payment of tax, would apply.

519. Subparagraph (e) ensures that where the Designated Payment Entity is subject to streamlined compliance, the Party does not require profit subject to Article 4 to be included in any income tax instalment regime (or advance tax). The reason for excluding profit subject to Article 4 from any instalment tax payment is because unlike other income, the calculation of profit under Article 4 only happens after the end of the Period.

520. Subparagraph (f) requires a Party to provide the deadline by which tax due in accordance with Article 4 must be paid is no later than 18 months after the Period. This reduces the number of different payment dates in multiple Jurisdictions in which a Covered Group has no taxable activities.

521. Subparagraph (g) requires Parties to ensure that where the Designated Payment Entity registers in a Jurisdiction solely because of Article 4, any domestic notices, registrations, or other actions not connected to the tax charged in accordance with Article 4 that would normally result from such a registration shall not apply.

Paragraph 2

522. For those Parties that choose to tax Amount A as part of their current income tax regimes, paragraph 2 establishes when a Party shall consider the Designated Payment Entity to qualify for the streamlined treatment outlined in paragraph 1. For the Designated Payment Entity to qualify for the streamlined compliance in a Party, it must have no income liable to tax in that Jurisdiction (other than Amount A Profit and income subject to a final withholding tax) and must not be benefitting from a regime permitting it to use income tax attributes of another Group Entity (for example, claiming group loss relief or being part of a tax consolidated group) in the Jurisdiction for the Period.

523. Where a Party taxes Amount A separately to its current income tax regime, the Designated Payment Entity shall always be eligible for streamlined compliance to meet its obligations under Article 4 to that Party, provided there is no reduction for tax attributes of other Group Entities. The intent of

paragraph 2 is to only limit streamlined compliance where there is an interaction between Article 4 and the current income tax regime of the Party for the Designated Payment Entity. The Designated Payment Entity will need to reassess its eligibility for streamlined compliance for each Period.

524. The reason for requiring Parties to restrict streamlined compliance with the criteria outlined in paragraph 2 (for those Parties that tax Amount A under their current corporate income tax regimes), is that in circumstances where the Designated Payment Entity has any other relevant interaction with an income tax regime in a Jurisdiction (i.e. other taxable income or the ability to use domestic losses) the entity would already have a current filing obligation in the Jurisdiction. Further, those Parties may need significantly more information than can be achieved through a harmonised Amount A Tax Return and Common Documentation Package, which only covers the calculation and information in relation to amounts under the Convention, not any other income tax obligation. Therefore, for those Parties, the Designated Payment Entity will need to comply with its income tax obligations, including the inclusion of Amount A Profit in accordance with paragraph 4, through the general income tax procedures of a Party.

Paragraph 3

525. Where a Party chooses to tax Amount A Profit using a separate income tax regime and where Amount A Profit is not offset with other tax attributes (such as group loss relief, if applicable under the domestic law of the Party) in the Period, the Party shall recognise the Designated Payment Entity to be eligible for streamlined compliance (even where it has income, other than Amount A Profit that is sourced in the market jurisdiction).

526. Conversely, where a Jurisdiction chooses to tax Amount A Profit under its current corporate income tax regime and allows for interaction with domestic tax attributes, the Designated Payment Entity will be required to meet the requirements of paragraph 2 to qualify for streamlined compliance.

Paragraph 4

527. Where streamlined compliance does not apply in a Party (i.e. where a Party allows Amount A Profit to interact with other tax attributes, and a Designated Payment Entity uses those other tax attributes), Parties are required to ensure that Amount A Profit will be included in the Designated Payment Entity's earliest income tax year for which the final income tax return has not been submitted. This includes an income tax year which may have ended but for which the final tax return has not yet been lodged, or was required to be lodged, before the filing deadline of the Covered Group's Amount A Tax Return and Common Documentation Package in the Party of the *lead tax administration*. The purpose of this deeming rule is to ensure taxation of Amount A through domestic procedures is not unduly delayed where streamlined compliance is not available. Such delays may create issues for Covered Groups in relation to the availability of double taxation relief for Amount A taxation.

528. Thus, where:

- a) the Designated Payment Entity is not eligible for streamlined compliance in a market jurisdiction:
and
- b) on the day of the Covered Group's Amount A Tax Return and Common Documentation Package is lodged in the Party of the *lead tax administration*, the Designated Payment Entity has not yet submitted a final tax return, or was required to submit a final tax return;

regardless of the fact the income tax year may have finished, the Designated Payment Entity shall include its Amount A Profit for the Period in that income tax return.

529. Where the filing of the final tax return in the market jurisdiction has occurred prior to the day the Covered Group's Amount A Tax Return and Common Documentation Package is required to be lodged in the Party of the *lead tax administration*, the Amount A Profit will be deemed to be derived on the day the Covered Group's Amount A Tax Return and Common Documentation Package is required to be lodged in the Party of the *lead tax administration*. This means Amount A Profit should be included in the current year income tax filing and also may be subject to tax under the market jurisdiction's instalment tax regime (if applicable).

Box 17. Example – Deeming rule

Jurisdiction X is the Jurisdiction of residence of the Designated Payment Entity and also has Amount A Profit allocated to it under Article 4. Jurisdiction X does not tax Amount A separately and allows for interaction with other tax attributes. As the Designated Payment Entity has other income subject to tax in Jurisdiction X, it is not eligible for streamlined compliance in relation to Amount A Profit in Jurisdiction X.

The Designated Payment Entity's income tax year and accounting year align (both end 31 December) in Jurisdiction X. Jurisdiction X is also the *lead tax administration* for the Covered Group and requires the Amount A Tax Return and Common Documentation Package to be filed no more than twelve months from the end of a Period.

For Amount A purposes, for FY25, the Amount A Tax Return and Common Documentation Package is due on 31 December 2026. As the Designated Payment Entity is not eligible for streamlined compliance in Jurisdiction X for FY25, it will:

If the (final) income tax return for FY25 in Jurisdiction X is required to be filed more than 12 months after the end of the income tax year – Amount A Profit for FY25 will be deemed to be derived on the last day of the FY25 income tax year and will be included in the FY25 final income tax return; or

If the (final) income tax return for FY25 in Jurisdiction X is required to be filed less than 12 months after the end of the income tax year – Amount A Profit for FY25 will be deemed to be derived on 31 December 2026 and will be included in the FY26 income tax return, including for instalment / advance tax purposes

Box 18. Examples – Streamlined Compliance

The following examples illustrate the application of streamlined compliance Article 16.

ABC Group is a Covered Group for Amount A. The UPE of the Group, ABC plc, is resident for tax purposes in Jurisdiction A, a Jurisdiction which has ratified the MLC. ABC plc has a financial reporting period of 1 January to 31 December. ABC plc is the Designated Payment Entity and *coordinating entity* for the Group.

ABC plc files the Amount A Tax Return and Common Documentation Package for the Group for FY2025 with its *lead tax administration* in Jurisdiction A on 31 December 2026.

By 31 March 2027, the *lead tax administration* will share the Amount A Tax Return and Common Documentation Package with the *affected parties*.

Example 1

Jurisdiction B is a market jurisdiction for ABC Group. ABC plc does not have any income liable to tax in Jurisdiction B, other than Amount A Profit. ABC plc is not benefitting from group loss relief or part of a tax consolidated group in Jurisdiction B. In this scenario, ABC plc meets the conditions of Article 16(2), and will qualify for streamlined compliance under Article 16 in Jurisdiction B.

The filing requirements for ABC plc in Jurisdiction B will be met when the Group's Amount A Tax Return and Common Documentation Package is filed with the *lead tax administration* in Jurisdiction A. The income tax year for ABC plc in Jurisdiction B will be 1 January 2025 to 31 December 2025. ABC plc (as the Designated Payment Entity) will pay the tax due in Jurisdiction B by 30 June 2027 (i.e. 18 months after the end of the Period).

Example 2

Jurisdiction C is a market jurisdiction for ABC Group. ABC plc receives interest income from a third party in Jurisdiction C. The payment of the interest to ABC plc is subject to a final withholding tax in Jurisdiction C, therefore ABC plc has no current income tax filing obligation in Jurisdiction C. ABC plc is not benefitting from group loss relief or part of a tax consolidated group in Jurisdiction C. As a result of this, ABC plc meets the requirements of Article 16(2), and will qualify for streamlined compliance under Article 16 in Jurisdiction C. The filing requirements of ABC plc in Jurisdiction C will be met when the Group's Amount A Tax Return and Common Documentation Package is filed with the *lead tax administration* in Jurisdiction A. The income tax year for ABC plc in Jurisdiction C will be 1 January 2025 to 31 December 2025, and it will pay the tax due on its Amount A Profit in Jurisdiction C by 30 June 2027 (i.e. 18 months after the end of the Period).

Example 3

Jurisdiction D is a market jurisdiction for ABC Group. Jurisdiction D does not tax Amount A Profit under a separate regime to non-Amount A related income. ABC plc has a permanent establishment in Jurisdiction D, with income (unrelated to Amount A) subject to tax in Jurisdiction D. The income tax year for ABC plc's permanent establishment in Jurisdiction D is 1 July 2024 to 30 June 2025. Due to it having income liable to tax, other than Amount A Profit, ABC plc does not meet the requirements of Article 16(2)(a) and will not qualify for streamlined compliance in Jurisdiction D. Accordingly, ABC plc will include its Amount A Profit in its tax return for the permanent establishment.

Following the rule in Article 16(4), the Amount A Profit of ABC plc's permanent establishment in Jurisdiction D would not straddle two income tax years. Instead, if the filing date of the tax return for income tax year 1 July 2024 – 30 June 2025 in Jurisdiction D is after 31/12/2026 (i.e. the filing date of the Amount A Tax Return and Common Documentation Package with the *lead tax administration*), the Amount A Profit would be included in the tax return for the income tax year 1 July 2024 – 30 June 2025, or where the filing date of the tax return for income tax year 1 July 2024 – 30 June 2025 in Jurisdiction D is before 31/12/2026, the Amount A Profit for the Period would be included in the tax return for the following income tax year.

Example 4

Jurisdiction E is a market jurisdiction for ABC Group. ABC plc does not have any income liable to tax in Jurisdiction E, other than Amount A Profit. ABC plc has a subsidiary entity, XYZ Limited, which is resident for purposes of tax in Jurisdiction E. XYZ Limited has an income tax year of 1 January 2025 to 31 December 2025 and has current year losses eligible for group loss relief. Jurisdiction E allows for the offset of group loss relief against Amount A Profit.

In this scenario, ABC plc can choose whether to use group loss relief to reduce its Amount A Profit liable to tax in Jurisdiction E.

If it chooses to do so, ABC plc can reduce its Amount A Profit liable to tax in Jurisdiction E by the eligible losses of XYZ Limited (i.e., claim group loss relief). If it does so, ABC plc will not meet the conditions of Article 16(2)(b) and will not qualify for streamlined compliance. Accordingly, ABC plc will have to file a local tax return in Jurisdiction E, noting its Amount A Profit and the group loss relief it is claiming. The timing of the filing of the tax return and the payment of tax will follow domestic law in Jurisdiction E.

Following the rule in Article 16(4), the Amount A Profit of ABC plc in Jurisdiction E for the Period is deemed to be derived for income tax purposes on 31/12/2025 and included in its tax return for FY2025 (where the filing date for the tax return for FY2025 is after 31/12/2026 (i.e. the filing date of the Amount A Tax Return and Common Documentation Package with the *lead tax administration*)), or is deemed to be derived on 31/12/2026 and included in the tax return for FY2026 (where the filing date of the tax return for FY2025 is before 31/12/2026).

However, if it chooses to not use the domestic losses (i.e., where ABC plc chooses not to offset the group loss relief against the Amount A Profit), ABC plc would meet the conditions of Article 16(2)(b), and therefore qualify for streamlined compliance. The filing requirements of ABC plc in Jurisdiction E will be met when it files its Amount A Tax Return and Common Documentation Package with the *lead tax administration* in Jurisdiction A. The income tax year for ABC plc in Jurisdiction E will be 1 January 2025 to 31 December 2025. ABC plc will pay the tax due in Jurisdiction E by 30 June 2027 (i.e. 18 months after the end of the Period).

Example 5

As noted above, the ABC plc, the Designated Payment Entity and *coordinating entity*, is resident for tax purposes in Jurisdiction A. Jurisdiction A taxes Amount A Profit under a separate regime to non-Amount A related income. Jurisdiction A does not allow for interaction between Amount A Profit and non-Amount A tax attributes.

Jurisdiction A is a market jurisdiction for ABC Group. In addition to Amount A Profit, ABC plc has non-Amount A related income subject to corporate income tax in Jurisdiction A.

Since Jurisdiction A chooses to tax Amount A Profit separately to non-Amount A income and does not allow for interaction with domestic tax attributes, ABC plc qualifies for streamlined compliance in Jurisdiction A under Article 16(3) and meets its Amount A filing requirements when it files its Amount A Tax Return and Common Documentation Package with the *lead tax administration* in Jurisdiction A. The income tax year for ABC plc in Jurisdiction A, for purposes of its obligations in relation to Amount A Profit, will be 1 January 2025 to 31 December 2025. ABC plc will pay the tax due in Jurisdiction A by 30 June 2027 (i.e. 18 months after the end of the Period). ABC plc's non-Amount A income tax obligations in Jurisdiction A remain unaffected.

Article 17 – Secondary liability

530. Article 17 is intended to require Parties to put in place mechanisms that allow for the imposition of liabilities in accordance with Article 4 on entities of a Covered Group other than the Designated Payment Entity, where the latter fails to meet those liabilities.

531. To assist with administration of Amount A, under the Amount A framework, the Designated Payment Entity legally owes an Amount A tax liability and *relief entities* are expected to compensate the Designated Payment Entity in relation to their entitlement to relief. Based on that, if the Designated Payment Entity fails to fulfil the liability, *relief entities* may bear the secondary liability to the extent that they should economically bear the Amount A tax liability (i.e. the *Amount A compensation payment limit* as per Article 13). This aligns with the obligation of the *relieving jurisdiction* to provide double taxation relief to the *relief entity* in relation to the Amount A tax liability in each market jurisdiction.

532. *Local entities* do not necessarily have a direct relationship with the Amount A tax liability owed by the Designated Payment Entity, but any Group Entity could be potentially related to the Amount A tax liability, given the nature of Amount A as taxation on a group basis. However, imposing secondary liability on all Group Entities would be disproportionate. If all Group Entities were subject to secondary liability, they would need to prepare for the possibility of secondary liability, while it would be unlikely in practice that market jurisdictions would collect tax from all Group Entities. Considering the balance between the effectiveness of tax collection and the compliance burden of a Group, the scope of secondary liability is limited to a *local entity* which is a resident of a market jurisdiction, to the extent of the Designated Payment Entity's Amount A tax liability imposed by the market jurisdiction.

533. *Relief entities* and *local entities* may bear secondary liability at the same time without any prioritisation and therefore market jurisdictions may collect tax from either, in any order. This enhances the effectiveness of tax collection by enabling market jurisdictions to prioritise entities which are expected to be able to pay any liabilities due.

Paragraph 1

534. Paragraph 1 allows a Party to impose an obligation in relation to Article 4 of the Designated Payment Entity, including administrative penalties, interest or other amounts imposed under domestic law in accordance with the Convention, on *relief entities* or *local entities* or a combination of both, in circumstances where the Designated Payment Entity does not meet its obligation.

535. Where a Party seeks to impose secondary liability on a *relief entity* or *relief entities* of a Covered Group, the liability cannot exceed the proportion of the tax liability owed by the Designated Payment Entity on the *Amount A relief amount* allocated to the *relief entity* in accordance with Article 13. This effectively restricts the amount of secondary liability of a *relief entity* to the amount it would have owed to each Party had it been directly liable under Article 4, rather than the Designated Payment Entity. Any amount attributable to interest or administrative penalties applied by the Party on the Designated Payment Entity, will similarly only be imposed on each *relief entity* in accordance with the *relief entity's* proportion of the Covered Group's *Amount A relief amount* allocated to it.

536. Similarly, a Party is not restricted to applying secondary liability to a single *local entity*, but may impose the liability on any, or all, *local entities* that are a resident of the Party. However, where secondary

liability is imposed on a *local entity*, the *local entity* shall be liable for the entire amount under Article 4 and any interest or administrative penalty amounts applicable.

537. The reference to “administrative penalty” in this Article is intended to only refer to administrative monetary penalties (for example, a non-filing penalty or flat penalty for non-payment) for the failure of the Designated Payment Entity to meet its tax obligation to a Party in accordance with the Convention. Article 17 does not cover a Party applying penalties on a *relief entity* or a *local entity*, or directors or employees of such entities, on the basis of non-payment of a secondary liability.

Paragraph 2

538. Paragraph 2 outlines the process a Party must undertake in order to impose a liability in accordance with Article 17. Where the Designated Payment Entity fails to meet its obligations under the Convention, a Party may, after three months from the date that obligation was due, provide a notice to a *relief entity* and / or a *local entity* requiring payment of the outstanding liability within 30 days of the issuance of the notice. The Party shall include in the notice:

- the amounts that remain unpaid;
- the date when the amounts first became payable; and
- any rights of appeal under the domestic laws of the Party.

539. It is intended that a Party will provide secondary liable taxpayers with the same rights of appeal that would be available to taxpayers with the same relevant characteristics subject to tax on business profits in the Party (as per Article 20(5)). However, the obligation is only on Parties to inform entities of their relevant rights of appeal under the domestic laws of the Party when such notices are issued. The obligation does not create any rights of appeal that do not already exist under the domestic law of the relevant Party. Similarly, the requirement that the Party to which the liability is owed needs to issue such a notice does not create any obligation for the *relieving jurisdiction* under the Convention.

540. A Party shall not be restricted as to whether it chooses to impose Article 17 on either *relief entities* or *local entities*, or concurrently, provided any payments in relation to an obligation of the Designated Payment Entity under Article 4 or this Article are subject to paragraph 3. Additionally, Article 17(1) does not extinguish the primary obligation of the Designated Payment Entity to pay tax to a Party in accordance with Article 4. As such, a Party is not restricted from continuing to pursue a Designated Payment Entity for payment after a notice has been issued to a *relief entity* or *local entity*.

Paragraph 3

541. Paragraph 3 prescribes that in the event a *relief entity*, *local entity* or the Designated Payment Entity makes a payment in relation to the liability subject to paragraph 1, the Party shall reduce any liability on another Group Entity subject to this Article. This ensures that Parties cannot receive an amount in excess of the amount which the Party would collect directly from the Designated Payment Entity.

Paragraph 4

542. Paragraph 4 contains the definitions for “*relief entity*” and “*local entity*” for purposes of this Article. A “*relief entity*” has the same meaning as in Article 13(12)(a). A “*local entity*” means a Group Entity of the Covered Group that is resident for tax purposes, or has a Taxable Presence in, the Party in which the liability arises in accordance with Article 4.

Article 18 – Adjustment of amounts due to tax certainty amendments

543. Article 18 provides that Parties shall put in place measures to allow for the offsetting of amounts under Articles 4 and 13 in a prior Period with similar amounts in a subsequent Period, where the change to the prior Period is a result of a *comprehensive certainty outcome*. The purpose of Article 18 is to mitigate delays in the implementation of a *comprehensive certainty outcome* by allowing a Designated Payment Entity to adjust payments to Parties in subsequent Periods.

544. Article 18 requires the offsetting of payments (either from the Designated Payment Entity or a Party) in a subsequent Period with short-falls or over-payment obligations of the Designated Payment Entity or a *relief entity* in the prior Period. The primary liability for tax on Amount A and the relief entitlement for the prior Period may remain unchanged under the Article and the relevant obligation to or of the Party is met through offsetting amounts owed or payable (either from the Designated Payment Entity or the Party) in the subsequent Period. Therefore, interest or administrative penalties in relation to underpayments of tax remain unchanged (unless Annex E Section 1(6) applies). Parties will have flexibility in the implementation of such offsetting. For example, a Party could implement offsetting in relation to liabilities or relief through:

- A direct deeming rule in its domestic law. Such a deeming rule could prescribe that any previous year short-fall or over-payment of taxation in relation to Amount A, as a result of a *comprehensive certainty outcome*, may be met by an inclusion of income or a deduction (or change in tax credit claimed for Amount A) of the short-fall or over-payment amount in the earliest available time after the *comprehensive certainty outcome* is made; or
- The use of the Jurisdiction's running account balance for the Designated Payment Entity or *relief entity*. As long as the previous year under-payment or over-payment is reflected in an adjustment in the running account balance of the relevant entity without the need to specifically reopen a previous year tax return, increasing or decreasing the next payment to the tax administration, this would be considered effective offsetting.

545. Unless mandated by a Party, the use of offsetting is not compulsory for Covered Groups. Groups may elect to use such processes or undertake to amend previous Period tax returns in accordance with the domestic procedures of the Parties.

546. Article 18 does not require for a Designated Payment Entity to have qualified for streamlined compliance in the current Period or in the Period to which the *comprehensive certainty outcome* relates, to be able to use offsetting enabled by Article 18. In a scenario where a Designated Payment Entity cannot qualify for streamlined compliance in a market jurisdiction (for example, it wishes to claim group loss relief in the Jurisdiction), the increase or decrease of the Amount A liability for the earlier period will be reflected in the domestic tax return instead of the Amount A Tax Return and Common Documentation Package.

Paragraphs 1 and 2

547. Paragraph 1 requires a Party to put in place a mechanism in its domestic law or administrative system that allows for payments made by a Designated Payment Entity in accordance with Article 4 to be adjusted to take into account an over or under-payment for a prior Period, in circumstances where that under or over-payment is a result of a *comprehensive certainty outcome*.

548. However, any adjustment by a Party shall not reduce the amount payable for the Period to below zero. Where an adjustment results in the subsequent Period payment being reduced to zero, any non-offset amount will be required to be claimed through the domestic procedures of the relevant Party.

549. Paragraph 2 requires a Party to put in place a mechanism in its domestic law or administrative system that allows for *relief entities* to adjust their relief entitlement in a subsequent year in accordance with Part IV, where there is a change to its relief entitlement for a prior Period due to a *comprehensive certainty outcome*.

550. Where paragraph 2 applies, a *relief entity* must recalculate its relief entitlement for the prior Period on the basis of any change resulting from a *comprehensive certainty outcome*. Rather than require the *relief entity* to amend the relevant domestic tax return lodged with the Party for the prior Period, the Party shall allow the *relief entity* to increase or decrease its entitlement to relief from double taxation in the subsequent Period.

551. Further, where the relief entitlement in the subsequent Period falls below zero, any excess will be required to be handled through the domestic procedures of the Party.

Box 19. Example – Adjustment of Amounts due to Tax Certainty Amendments

All amounts in the examples below are denominated in the same currency for simplicity.

A Covered Group (EG Group) applied for *comprehensive certainty* when it filed its Amount A Tax Return and Common Documentation Package for its year ending 31/12/2025 (“FY25”). During the 2028 fiscal year (“FY28”), the *comprehensive certainty outcome* was agreed.

As part of the *comprehensive certainty outcome*, the following adjustments were made to the Amount A Profit liable to tax for FY2025:

- Jurisdiction B’s Amount A Profit was increased by EUR 50
- Jurisdiction C’s Amount A Profit was increased by EUR 160
- Jurisdiction D’s Amount A Profit was increased by EUR 100
- Jurisdiction E’s Amount A Profit was increased by EUR 25

Following the provisions of Article 18, EG Group reflects the adjustments required in Jurisdictions B to E as part of the *comprehensive certainty outcome* in its Amount A Tax Return and Common Documentation Package for its fiscal year, ending 31/12/2027 (“FY27”). It includes the adjustments in the FY27 Amount A Tax Return and Common Documentation Package as it is the most recent Period for which an Amount A Tax Return and Common Documentation Package has not been filed. The Designated Payment Entity of EG Group, EG PLC, a resident of Jurisdiction A, qualifies for streamlined compliance in FY27 in each of Jurisdictions B to E.

As a result of the adjustments to the Amount A Profit liable to tax in the market jurisdictions, there is a corresponding increase in entitlement to relief from double taxation in the *relieving jurisdictions*. EG Group is entitled to additional relief from double taxation in Jurisdictions F to I. It includes the adjustments to the FY25 entitlement to relief from double taxation in its domestic tax returns in

Jurisdictions F to I.

EG Group's Summary Table of amounts due to Market Jurisdictions in the Amount A Tax Return and Common Documentation Package for fiscal year ending 31/12/2027:

Designated Payment Entity name:	Tax jurisdiction of residence of the Designated Payment Entity	Market Jurisdiction to which tax is owed	Amount A Profit liable to Tax FY27	Applicable Corporate Tax Rate (%)	Tax Liability FY27	Adjustments due to Previous Period (FY25)	Net Payment Amount to be made
EG PLC	Jurisdiction A	Jurisdiction B	EUR 1000	20%	EUR 200	+EUR 10	EUR 210
		Jurisdiction C	EUR 1000	25%	EUR 250	+EUR 40	EUR 290
		Jurisdiction D	EUR 100	15%	EUR 15	+EUR 15	EUR 30
		Jurisdiction E	EUR 75	40%	EUR 30	+EUR 10	EUR 40

EG Group's Summary Table of relief entities' entitlement to double taxation relief for fiscal year ending 31/12/2027:

Relieving Jurisdiction	Relief Entity Name	Relief Payment FY27	Adjustments due to Previous Period (FY25)	Net Relief Payment
Jurisdiction F	EG F Limited	EUR 200	+EUR 51	EUR 251
Jurisdiction G	EG G Limited	EUR 50	+EUR 13	EUR 63
Jurisdiction H	EG H Limited	EUR 20	+EUR 5	EUR 25
Jurisdiction I	EG I Limited	EUR 25	+EUR 6	EUR 31

Article 19 – Requirement to have an internal control framework

Paragraph 1

552. Article 19 stipulates that Parties require Covered Groups to develop an *internal control framework*. This is an obligation on the Group to keep intelligent records to explain its approach to revenue sourcing. If applicable, the Group is obliged to do the same regarding:

- its approach to the categorisation of revenues and costs for the purpose of applying Annex C Sections 2 and 3;
- its methodology for determining *non-RFS adjusted profit before tax* (as modified by Annex C Section 4); and
- its methodology for determining *non-extractives adjusted profit before tax* (as modified by Annex C Section 4).

553. This is separate to the process that tax administrations (and/or the *review panel* or *determination panel*) would use to verify compliance with the approach described in the *internal control framework*.

Paragraph 2

554. “Internal control framework” is a defined term and means a suite of policies and procedures which is endorsed by the relevant senior management of the Ultimate Parent Entity and designed to ensure the accurate application of Articles 6 and 7. If applicable to a Group, the suite of policies and procedures extends to:

- the categorisation of revenues and costs for the purpose of applying Annex C Sections 2 and 3;
- the methodology for determining *non-RFS adjusted profit before tax* (as modified by Annex C Section 4); and
- the methodology for determining *non-extractives adjusted profit before tax* (as modified by Annex C Section 4).

555. The relevant senior management could be the board of directors of the Ultimate Parent Entity, but it could also be another layer of management that has the relevant responsibilities regarding Amount A, such as the management that has operational responsibility for financial affairs and/or tax matters. It is relevant that the relevant senior management is appropriately informed and that any potential risks regarding revenue sourcing are being reported, e.g. when there are changes in the *reliable method*.

556. Endorsement by “senior management” would require a group of persons or an individual with sufficient seniority and responsibility to endorse the *internal control framework*. This will depend on each Covered Group’s internal delegation procedures. However, as a minimum, the expectation would be that endorsement of the *internal control framework* would be required at least by the Chief Financial Officer of the Covered Group or the Audit and Risk Committee (or equivalent) of the Group or, where such endorsement is delegated by the individual responsible for the Group’s global taxation obligations (i.e. the Global Head of Finance or the Global Head of Taxation for the Covered Group).

557. For the *internal control framework* to be regarded as endorsed by senior management, whilst this will depend on the internal delegation procedures of the Covered Group, it is envisaged that this would entail approval by the relevant person(s) or committee and for this approval to be noted in the minutes of a meeting of senior management (for example, an audit committee meeting) or directly in the *internal control framework* itself.

558. The purpose of the *internal control framework* is to provide a detailed way to explain the approach taken to complying with the revenue sourcing rules, to enable the relevant tax administrations to review, question and verify the approach. The *internal control framework* is necessary because the review of compliance with the revenue sourcing rules (and if applicable, the categorisations and methodologies listed in subparagraphs (b), (c) and (d)) is based on a review of systems, rather than a review of every underlying transaction.

Article 20 - Amounts arising under this convention

559. Article 20 deals with the obligations of a Party in relation to amounts arising under the Convention. The following paragraphs, generally, require that a Party not provide less favourable treatment in relation

to liabilities imposed in accordance with or related to the Convention and ensure that the timely fulfilment of the obligations of Covered Groups in accordance with the Convention are not hindered by other measures in the domestic law of a Party. However, it is noted that Article 20 does not preclude a Party from having more favourable conditions in relation to liabilities imposed in accordance with or related to the Convention.

Paragraph 1

560. Paragraph 1 requires that Parties do not impose a rate of tax on amounts subject to Article 4 that would be in excess of that which would apply in accordance with the taxation in that Party of business profits of an enterprise carried on by a body corporate with the same relevant characteristics. This acts as a limit to ensure that taxation in accordance with the Convention is non-discriminatory compared to the income tax regime generally applicable in the Party to business profits.

561. In determining the “same relevant characteristics”, as liabilities imposed as a result of the Convention fall on the Designated Payment Entity, in most cases this would mean the same relevant characteristics would be an entity resident in a foreign Jurisdiction with taxable business profits in the Party. Therefore, the relevant applicable tax rate in such circumstances would be that at which the Party taxes permanent establishments in the Party of foreign resident companies. However, where the Designated Payment Entity is a resident of a Party which has a bilateral tax treaty with the Party that is taxing business profits in accordance with Article 4, the Articles of that treaty as they affect the taxation of business profits are also relevant.

562. In accordance with paragraph 1, a Party shall be allowed to include the effect of subnational income taxes, in certain situations, regardless of whether such taxes are levied directly by subnational Jurisdictions or indirectly by federal government, in determining the tax rate that would have been paid in accordance with the income tax regime generally applicable in that Party on business profits of an enterprise in that Party. The purpose of this provision is only to allow for Parties to apply taxation at a tax rate inclusive of subnational income tax rates in specific circumstances, and not to directly confer a right to taxation under the Convention to subnational governments.

563. The inclusion of a subnational income tax in the tax rate ceiling in respect of a Period is only allowed in circumstances where:

- the subnational income tax generally applies to business profits of an enterprise carried on by a body corporate with the same relevant characteristics;
- relief for Amount A is calculated based on any subnational income taxes included in the tax rate ceiling in respect of the Period. That is, in calculating the relief provided to a *relief entity* under the Convention, a Party must also provide relief on a basis inclusive of any subnational income taxes; and
- the *subnational entity* which levies the income tax has not been determined to have enacted a subnational DST or Relevant Similar Measure under Annex H(11) through (14) that is in effect for the Period.

When one of these conditions is no longer met, the subnational income tax cannot be included in the computation of the tax rate ceiling, which leads to a decrease in the tax rate ceiling. If needed, the federal tax rate imposed on Amount A shall be reduced to ensure compliance with the decreased tax rate ceiling.

564. In determining the tax rate ceiling in paragraph 1, how a federally levied income tax and subnational income taxes interact will determine the appropriate tax rate. For example, it is straightforward in situations where subnational income tax is applied on the same or substantially the same tax base as federally levied income tax. Therefore, the tax rate prescribed in paragraph 1 would be the federally levied corporate income tax rate plus the tax rate of the relevant subnational income taxes. Where the rate of subnational income taxes is not uniform, Parties shall be permitted to use a weighted average of the applicable subnational income taxes. A Party shall be free to determine which weighted average metric it chooses to base such a calculation, provided the relevant metric is a reasonable approximation of the distribution of taxable income between its subnational jurisdictions. Such metrics may include but are not limited to a basis of *final consumption expenditure*, Gross Domestic Product, population or taxable income derived in each subnational jurisdiction. However, in all instances the metric needs to be based on a weighted average. Where an income tax levied by a subnational government does not meet the conditions above, the subnational government's tax rate will be deemed zero, for the purpose of determining the weighted average.

565. Where the federally levied income tax rate is reduced in circumstances where a subnational income tax also applies (i.e. the tax rate at a federal level is lowered to provide headroom for subnational taxes), the reduced tax rate of the federally levied income tax (not the headline tax rate) is the relevant rate to which the weighted average subnational income tax rate is added. However, to the extent that this results in a ceiling below the federally levied tax rate (prior to the reduction for subnational taxes), the federal income tax rate shall be the ceiling without adjustment for subnational income taxes. This may apply in particular when a Jurisdiction does not satisfy the conditions described in paragraph 563, leading to a decrease of the weighted average as per this paragraph and paragraph 564.

566. As paragraph 1 only prescribes a tax rate ceiling, and not the applicable rate of taxation for Amount A Profit, a Party may set its rate of taxation on Amount A Profit inclusive of subnational income taxes but below the prescribed tax rate ceiling. Where this occurs, the Party will be considered to have met the requirements of paragraph 1, if it provides relief for Amount A Profit in accordance with Article 12, on a basis inclusive of any subnational income taxes. However, where relief for subnational income taxes is provided via exemption, it will not be considered compliant for purposes of paragraph 1, as the use of the exemption method is not prescribed in Article 12(1) and those subnational income taxes cannot be included in the tax rate ceiling.

Paragraph 2

567. Paragraph 2 requires that Parties take appropriate measures in their domestic law to the extent necessary to effectively enforce compliance in relation to a tax liability imposed by that Party under Article 4. This requires a Party to ensure that any liabilities imposed by that Party are backed by effective enforcement mechanisms in its domestic law. However, as prescribed by paragraphs 3 and 4, such mechanisms cannot be in excess of those imposed for a similar offense in relation to business profits of an enterprise with the same relevant characteristics under the income tax regime generally applicable in that Party.

Paragraph 3

568. Paragraph 3 requires that a Party shall not impose interest or administrative penalties in relation to a tax liability or obligation related to that tax liability in accordance with Article 4 that exceed those that would apply if a similar offence in relation to business profits of an enterprise with the same relevant characteristics under the income tax regime generally applicable in that Party. Paragraph 3 only applies to interest imposed and payable to a Party. Paragraph 3 does not apply to interest that may be payable by a Party in relation to underclaimed relief or an overpaid liability.

Paragraph 4

569. Paragraph 4 requires a Party to take appropriate measures in its domestic law to ensure that payments made in accordance with Article 4 and compensation payments in accordance with Article 13 can be made by Group Entities in a timely manner.

570. Parties to the Convention may have measures, such as currency controls, foreign exchange controls or currency exchange controls, contained in their domestic law that regulate or limit cross-border currency transactions. Paragraph 4 does not prohibit such measures applying to payments made in accordance with the Convention. However, it does require a Party to ensure that such measures do not hinder the timely payments of amounts under the Convention. The scope of such measures is relevant when considering whether such measures hinder timely payment of amounts under the Convention, including whether such measures relate to all cross-border currency transfers or only those in the local currency of the Party. Where the latter is the case, the fact that Covered Groups can arrange their affairs in a different currency without being subject to such measures is a relevant consideration.

571. Parties shall not be required to put in place any special measures to meet their obligation under paragraph 4, provided their current processes allow for payments made in the satisfaction of amounts covered by the Convention in a timely manner.

Paragraph 5 and 6

572. Paragraph 5 sets out an obligation on a Party that its domestic laws regarding the rights of appeal or review, the rules in relation to audits and the statute of limitations applicable to entities subject to tax in accordance with the Convention should not provide less favourable conditions than those applicable to entities with the same relevant characteristics under its income tax regime.

573. Paragraphs 1 and 3 deal with non-discrimination in relation to rate of taxation, and interest and administrative penalties, respectively. Paragraph 5 specifically deals with the formalities concerned with such taxation in relation to rights of appeal, audits and statute of limitations. However, this specific obligation against less favourable conditions does not extend to circumstances where the formalities associated with taxation are in relation to an obligation under the Convention.

574. Notwithstanding this obligation, paragraph 6 allows a Party to the Convention to extend the statute of limitation on the assessment of tax for the period in which it is restricted from undertaking compliance activities pursuant to Articles 22(6) and 23(5). The “assessment of tax” takes its ordinary meaning as the act of computing tax due under the domestic laws of the relevant Party. The purpose of this exception is to ensure that Parties are not adversely impacted by a MNE group’s decision to avail itself of the tax certainty processes for Amount A. Such an adverse impact could arise if the MNE group withdraws (or is deemed to have withdrawn) a request for certainty with respect to Amount A before an outcome is reached. Accordingly, a Party may adopt a provision under domestic law that suspends the statute of limitations on assessment for the duration of any period in which the Convention restricts compliance activities without violating the general principle set forth in Article 20(5).

575. For example, a Party may have a three-year statute of limitation on assessment that applies to taxpayers subject to income tax in its Jurisdiction. Therefore, under Article 20(5) the three-year statute of limitation also applies to assessments in relation to tax in accordance with Article 4. If a Covered Group’s request for *comprehensive certainty* for the Period has been accepted, all Parties must suspend domestic compliance activities under Article 23(5) for the Period. Parties are required under the Convention to implement any *comprehensive certainty outcome* regardless of their domestic laws (including statute of limitations). However, if the Covered Group later withdraws its request for *comprehensive certainty*, a Party

may be precluded from assessing a tax that it is otherwise entitled to. To prevent such circumstances from occurring, Article 20(5)(b) allows Parties to enact domestic legislation that suspends the statute of limitations for the period in which the Convention restricts compliance activities. Some Jurisdictions may provide for a new statute of limitations (e.g. three years after the Covered Group withdraws its request for *comprehensive certainty*) instead of suspending the current statute of limitations. The new statute of limitations would be subject to the general prohibition under paragraph 5.

Article 21 – Currency conversion rules for calculations and liabilities

576. Article 21 deals with foreign currency translation rules for Amount A related calculations and thresholds. In undertaking the relevant calculations required under the Convention, there are instances where amounts may be required to be translated into a common currency. To ensure consistency in the application of these translations between Parties, it is required that all amounts are translated according to the following rules. Paragraphs 2 through 4 are meant to ensure that in all circumstances, identical outcomes will apply in all Parties as to whether a Group is above or below an Amount A related threshold.

Paragraph 1

577. Paragraph 1 requires that any amounts used in calculations for Amount A are translated to the presentation currency of the Consolidated Financial Statements of the Covered Group. This establishes that all the relevant calculations for Amount A purposes should be undertaken in the presentation currency of the Consolidated Financial Statements of the Covered Group. In undertaking the relevant foreign exchange translations, Covered Groups will be required to translate such amounts to the presentation currency of the Consolidated Financial Statements of the Covered Group, in accordance with the Acceptable Financial Accounting Standard applicable to the Consolidated Financial Statements. This applies not only to amounts that are reflected directly in the Consolidated Financial Statements, but also those that may be subject to elimination as part of the consolidation process. As such, all amounts should be translated to the presentation currency of the Covered Group under the Acceptable Financial Accounting Standard applicable to the Consolidated Financial Statements regardless of whether the accounting standard applies to those amounts.

578. However, “any amount relevant to the Convention” does not include the translation of any relevant tax liability applied to Amount A Profit in accordance with Article 4. For the purpose of determining the tax payable by the Designated Payment Entity, a Party will be free to determine the relevant foreign currency translation rate in accordance with its domestic law, provided the rate is reasonable and referable to the Period. As such, the Covered Group will calculate the Amount A Profit attributable to a Party in accordance with Article 4 and the other Articles of the Convention in the presentation currency of the Covered Group. This will result in an amount of Amount A Profit allocated to the Party under Article 4 in the presentation currency of the Covered Group. A Party may then, have domestic foreign exchange translation rules to convert the Amount A Profit from the presentation currency of the Covered Group, to the local currency for the purpose of determining the amount of profit to be included in the domestic tax return (if streamlined compliance does not apply) or the liability and payment to be included as part of the Amount A Tax Return and Common Documentation Package. This similarly applies to the calculation of relief provided to *relief entities*.

Paragraphs 2 and 3

579. Paragraphs 2 and 3 specifically deal with circumstances where a Party decided to express the relevant monetary thresholds within the Convention in their domestic law based on local currency rather

than a euro-denominated amount. To ensure a coordinated application of the rules and consistency across Parties, harmonised foreign exchange translation rules in relation to these thresholds are required.

580. Where monetary thresholds in the Convention are expressed in domestic legislation in a non-euro denominated currency, paragraph 2 provides that these thresholds will need to be rebased annually to ensure a co-ordinated and consistent application and scope of the Convention across Parties. This applies to all euro-denominated thresholds within the Convention.

581. Where the aforementioned thresholds are expressed in domestic legislation in a non-euro currency, the amounts will need to be rebased to ensure a coordinated application of the Convention as well as consistency in the thresholds used by different Parties on an ongoing basis. To ensure equivalency with the euro denominated amounts as well as across Jurisdictions, the thresholds should be rebased as of the same date and using equivalent current exchange rates. Those rebased thresholds should apply consistently for the reporting Period starting as of (or with a start date that is set by reference to) a common date following the rebasing, such as 1 January (including a Period with a start date such as the Sunday nearest to 1 January).

582. Greater certainty is provided when the applicable monetary thresholds are known to Covered Groups prior to the commencement of the relevant Period. Parties should hence rebase the local currency thresholds provided in their domestic legislation based on an exchange rate that is available at the beginning of a Period at the latest. Therefore, the rebasing of the relevant thresholds should be undertaken with reference to the average foreign exchange rate for the December month immediately prior to the commencement of the relevant calendar year.

583. Where the relevant Article in the Convention includes a threshold that references previous Periods, the foreign exchange rate for each individual year will be based on the average foreign exchange rate for December of the calendar year immediately preceding the calendar year in which such previous Period starts, rather than a single exchange rate applied for purposes of all the relevant Periods.

584. The applicable average foreign exchange rate will be determined by:

- the foreign exchange reference rates as quoted by the European Central Bank (ECB); or
- where the ECB does not provide a foreign exchange reference rate for the local currency of a Jurisdiction, or the Jurisdiction faces legal or practical impediments to using such exchange rate when setting their own monetary thresholds under domestic legislation, the average foreign exchange rate will be determined by that quoted by the Jurisdiction's central bank.

Paragraph 4

585. Paragraph 4 applies to align the translation of the relevant amounts, calculated in accordance with paragraph 1, in the presentation currency of the Covered Group's Consolidated Financial Statements, to the relevant thresholds to which paragraphs 2 and 3 apply.

586. Where the presentation currency of the Covered Group's Consolidated Financial Statements differs from the currency a Party expresses the relevant Amount A thresholds in, Covered Groups will be required, for purposes of each Party's domestic law, to translate amounts from the presentation currency of the Covered Group to the specified currency of the threshold in each Party.

587. As a Party may determine the relevant threshold in its local currency, and such thresholds are rebased annually based on the average rate of the December month in the prior calendar year to the

commencement of the Period, the use of any other exchange rate will potentially give rise to distortions in the application of such thresholds to a Covered Group, due to exchange rate differences. Therefore, to ensure consistency of the application of these thresholds across all Parties, Parties shall require Covered Groups, when applicable, to translate amounts from the presentation currency of the Covered Group's Consolidated Financial Statements to the currency in which the threshold is expressed in domestic law, based on the same rate as prescribed under paragraphs 2 and 3. That is, translate the relevant amounts based on the average foreign exchange rate for December of calendar year immediately preceding the commencement of the Period.

Section 2 – Tax certainty framework for Parts II to IV (Amount A)

Article 22 – Requests for certainty over whether a Group is a Covered Group

Paragraph 1

588. Paragraph 1 allows a Group to request *scope certainty* that it is not a Covered Group for a Period specified in the request, because it does not meet the Revenue Test and/or the Profitability Test in Article 3. A request for *scope certainty* must be accompanied by payment to the *lead tax administration* of the relevant *tax certainty user fee*.

589. A request for *scope certainty* under paragraph 1 covers the following aspects of the Convention, where relevant to a particular case. Where a particular aspect is not relevant in determining whether a Group is a Covered Group, it shall not be covered by a *scope certainty review*.

- a) The identification of the Ultimate Parent Entity and application of the definition of a Group.
- b) The calculation of Adjusted Revenues and application of the revenue test.
- c) The calculation of the *pre-tax profit margin* and application of the profitability test.
- d) Issues with respect to the application of rules on *qualifying extractives groups* and Groups that include one or more *regulated financial institutions*, including:
 - i) whether the Group meets the definition of a *qualifying extractives group* or Group that includes one or more *regulated financial institutions*,
 - ii) the Group's methodology for demonstrating that it does not meet, as applicable,
 - (1) the non-extractives revenue test,
 - (2) the non-extractives segment revenue test,
 - (3) the non-RFS revenue test, or
 - (4) the non-RFS segment revenue test,

and the application of the applicable test, if relevant, and

iii) the Group's methodology for determining, as applicable,

(5) *non-extractives adjusted profit before tax* (as modified by Annex C Section 4), or

Non-RFS adjusted profit before tax (as modified by Annex C Section 4),

and the application of the non-extractives profitability test, non-extractives segment profitability test, non-RFS profitability test, or Non-RFS segment profitability test, if relevant.

e) Issues with respect to the application of rules on Segmentation, including:

i) the identification of one or more *disclosed segments* of the Group,

ii) the Group's methodology for calculating segment revenues and application of the segment revenue test,

iii) the Group's methodology for calculating *segment pre-tax profit margin* and application of the segment profitability test, and

iv) if the Group is a *qualifying extractives group* or a Group that includes one or more *regulated financial institutions*, the issues mentioned in subparagraph (d) as they relate to the *disclosed segments*.

f) Issues with respect to the application of rules on *internal fragmentations*, including:

i) the ownership structure of the Group,

ii) whether an *internal fragmentation* has occurred,

iii) whether the Group's Total Revenues and those of other Fragmented Groups resulting from the same *internal fragmentation* meet the revenue test, and

iv) whether failing the revenue test in Article 3(1)(a) is one of the principal purposes of the *internal fragmentation*.

g) Any other issues relevant to whether the Group is a Covered Group or a *disclosed segment* is a *covered segment* for the Period.

590. In order to ensure that a *scope certainty review* is coordinated, both on the part of the Group and on the part of tax administrations, a request should be submitted by the *coordinating entity* of a Group to the *lead tax administration* of that Group.

591. A request for *scope certainty* must be submitted within certain time windows, set out in paragraph 1. No request can be submitted before the Convention has been in force for 365 days.

592. Subparagraph (a) sets out the earliest date upon which a request for *scope certainty* may be submitted, after the Convention has been in force for 365 days. Subdivision (i) provides a general rule that a request may be submitted on or after the last day of the Period to which the request relates. This is because, in most cases, providing certainty that a Group is not a Covered Group requires information on the Group's revenues and profits for a Period, and this information will not be complete until the Period is ended.

593. Article 3(2) includes a specific rule that, where a Group was not a Covered Group in the immediately preceding two Periods (or where the Group was only in existence for one preceding Period, in that Period), two further tests must be met in order for a Group to be a Covered Group. Paragraph 1(a)(ii) provides that, where a Group considers that it does not meet one or both of these tests, it may submit a request for *scope certainty* once it has the information to demonstrate this, even if this means that the request is submitted before the last day of the Period to which it relates.

594. Subparagraph (b) sets out the latest date upon which a request for *scope certainty* may be submitted. Subdivision (i) provides a general rule that a request may be submitted up to the deadline for the filing of an Amount A Tax Return and Common Documentation Package for the Period to which the request relates.

595. In addition to this general deadline, where a Group does not submit a request for *scope certainty* as it does not consider itself to be a Covered Group for a Period, but is subsequently notified that the tax administration of a Party intends to commence enquiries as to whether the Group is a Covered Group, paragraph 1(b)(ii) provides that the Group has 90 days from being informed of this fact to submit a request for *scope certainty*. This recognizes the benefit of a consistent application of the Convention by Parties, even when a Group does not initially request *scope certainty*.

596. Paragraph 1(b)(iii) provides that the Conference of the Parties may agree further deadlines that shall allow a Group to submit a request for *scope certainty* in other circumstances.

Paragraph 2

597. Under Paragraph 2, where a Group is a *qualifying extractives group* or a Group that includes one or more *regulated financial institutions*, and the *coordinating entity* of the Group submits a request for *scope certainty* that the Group was not a Covered Group for a Period, it may at the same time submit a request a *scope advance certainty* with respect to its application of rules under Annex C Section 2 or 3, as appropriate. This request shall also be with respect to aspects of a Group's *internal control framework* that are relevant to the particular approach covered by the request. A request for *scope advance certainty* must be accompanied by payment to the *lead tax administration* of the relevant *tax certainty user fee*.

598. For Groups that fall within the scope of the rules in Annex C Section 2 or 3, the correct application of these rules will be fundamental to whether they are considered a Covered Group for a Period, and this may involve the introduction of new methodologies to collect and present information on a Group in a form that is not currently required for any other purpose. It may also require changes to aspects of a Group's *internal control framework* to ensure these methodologies are being applied correctly and the information provided in a Group's *scope certainty documentation package* is accurate. As such, paragraph 2 allows a Group to request certainty that *listed parties* agree in advance the approach that shall be taken by a Group for a Period specified in the request for *scope advance certainty*, and for a specified number of later Periods subject to conditions, and also that relevant aspects of the Group's *internal control framework* are considered to be designed and operating effectively. Subject to Article 26, Article 29 and Annex F Section 1, an approach covered by an *advance certainty outcome* shall not be considered further as part of a *scope certainty review* for a Period in which that *certainty outcome* applies, reducing the risk of disagreements and increasing the efficiency of the *scope certainty review* process for Groups and *listed parties*.

599. Subparagraph (c) provides that the Conference of the Parties may agree that *scope advance certainty* shall be available over other provisions of the Convention.

Paragraph 3

600. Paragraph 3 provides that the *lead tax administration* shall accept a valid request for *scope certainty* or *scope advance certainty* on behalf of *listed parties*.

601. A valid request is one that is submitted by the deadlines in paragraphs 1 and 2, as applicable, which is accompanied by a *scope certainty documentation package* or *advance certainty documentation package*, as relevant, and which complies with the format agreed by the Conference of the Parties. Payment of the applicable *tax certainty user fee* must also have been made to *the lead tax administration*.

602. Where a request is not in the correct format or is not accompanied by the required documentation, the *lead tax administration* shall require this to be corrected within 60 days, though this may be extended by a further 90 days if the *coordinating entity* explains why more time is needed to make the correction or provide the missing documentation and this is agreed by the *lead tax administration*. Where a corrected request or the missing documentation is not submitted to the *lead tax administration* by this deadline, the *coordinating entity* is considered to have withdrawn its request for certainty.

603. Paragraph 3 also provides that where a request is accepted, the request and complete documentation package shall be exchanged with all *listed parties* within 30 days. Where a request for *scope certainty* is accepted, all Parties that are not *listed parties* shall be notified that this is the case by the same deadline.

Paragraph 4

604. Paragraph 4 provides a process whereby the Competent Authority of a Party that is not included as a *listed party* by the *coordinating entity* can notify the Competent Authority of the *lead tax administration* that it considers that the Party for which it is Competent Authority should be a *listed party*, for example because it is a Jurisdiction in which the Group has revenues in excess of the nexus threshold in Article 8. This should be accompanied by any documentation or other evidence to support the Competent Authority's position, such as that described in Annex F Section 4.

605. The *lead tax administration* may consult with the *coordinating entity* to consider whether the Party should be added to the list of *listed parties* but is not required to do so. Where this consultation does happen and the *coordinating entity* agrees that the Party is a *listed party*, the Party shall be added to the list of *listed parties*. Even where the *coordinating entity* does not agree, or if the *lead tax administration* does not consult with the *coordinating entity*, if the *lead tax administration* considers that the Party has a reasonable basis for being included as a *listed party*, it shall be added to the list of *listed parties*. If the Party is added to the list of *listed parties*, the Competent Authority of the Party is informed and within 15 days all information already exchanged with the Competent Authorities of *listed parties* shall be exchanged with the Competent Authority of that Party.

Paragraph 5

606. In general, where a Group submits a request for *scope certainty*, certainty shall be provided by all *listed parties* included in the Group's request and those that are added to this list in accordance with a process in paragraph 4.

607. Notwithstanding this, paragraph 5 provides that, where a request for *scope certainty* is made within 90 days after the Ultimate Parent Entity of a Group or any Group Entity is notified that a Party intends to commence enquiries as to whether the Group is a Covered Group, another Party had previously notified the Group that it intended to commence such enquiries, and the Group did not submit a request for *scope*

certainty within 90 days of that notification, that other Party may notify the *lead tax administration* that it shall not be a *listed party* for purposes of the *scope certainty review*. This balances the need for a Group to be able to request certainty where it is aware that a tax administration considers that it may be a Covered Group with the need for a tax administration to be able to undertake enquiries under its domestic law where notice is given to a Group but no request for *scope certainty* is submitted.

Paragraph 6

608. Where the Competent Authority of a *listed party* is notified through the process in paragraph 3 that a request for *scope certainty* has been accepted, that *listed party* shall suspend any domestic enquiries that are ongoing, and shall not commence any new enquiries, as to the application of the Convention to Group Entities of that Group with respect to the Period covered by the request. The *listed party* may take the minimum procedural steps required to protect its ability to undertake compliance activity later, such as opening an enquiry on a protective basis, but may not take substantive action such as requesting information from a Group Entity or issuing a tax assessment.

609. Paragraph 6 does not prevent a *listed party* from undertaking enquiries for a Period that is not covered by a request for *scope certainty*, or with respect to matters not covered by the Convention, including *related issues*.

610. The obligation to suspend domestic enquiries under paragraph 6 shall cease to apply in circumstances where the *coordinating entity* notifies the *lead tax administration* that it withdraws its request for *scope certainty* or is otherwise considered to have withdrawn its request in accordance with Article 30(1).

611. This obligation shall also cease to apply where:

- a) the *scope certainty outcome* provided to a Group includes a decision that the Group is a Covered Group, and the Group did not submit a request for *comprehensive certainty* by the deadline in Article 29(1)(b), or
- b) the *scope certainty outcome* agreed following a *follow-up scope certainty review* provides that it was not possible to agree that the Group continues not to be a Covered Group, or the *coordinating entity* withdraws its request for *follow-up certainty* and informs the *lead tax administration* that it intends to submit a request for *scope certainty* or *comprehensive certainty*, and the Group did not submit a request for *scope certainty* or *comprehensive certainty* by the relevant deadline in Article 29(2)(b) or in Annex F Section 1(18), as applicable.

612. This ensures that, where one certainty process has come to an end, but there is an expectation that a second process (either a *scope certainty review* or *comprehensive certainty review*) will be requested for the same Period, domestic compliance activity is not commenced before the deadline for that request is reached. However, if a second request for certainty is not submitted by this deadline, a Party is not prevented from undertaking enquiries under its domestic law.

Paragraph 7

613. Paragraph 7 provides that the Conference of the Parties may agree a specific *follow-up scope certainty review* process where a Group has previously been found not to be a Covered Group, and particular conditions apply. This will simplify the process for determining that a Group continues not to be a Covered Group for certain Groups and for tax administrations with respect to these Groups.

614. Where it is not possible as a result of a *follow-up scope certainty review* to conclude that a Group continues not to be a Covered Group, a Group may within 90 days of being informed of this submit an updated request for a *scope certainty review* for the same Period. This recognizes the fact that a *follow-up scope certainty review* may be based on simplified documentation requirements and allows a Group the opportunity to request a *scope certainty review* based on fuller documentation before it is concluded that the Group is a Covered Group.

Paragraph 8

615. Where a Group has submitted a request for *scope certainty* but then has withdrawn that request, or is considered to have done so under Article 30, a further request for *scope certainty* shall not typically be accepted for the same Period.

616. Paragraph 8 does not prevent a *coordinating entity* from requesting *scope certainty* where it has notified the *lead tax administration* that it is withdrawing its request for *follow-up scope certainty* but intends to submit a request for *scope certainty*, and it submits a request for *scope certainty* accompanied by a *scope certainty documentation package* within 90 days.

617. Where a *scope certainty review* was undertaken by the *lead tax administration*, and this review concluded without a *scope certainty outcome* because the *lead tax administration* determined that the *coordinating entity* was persistently late in providing information without explanation or acted in an uncooperative or non-transparent manner, including by providing inaccurate or incomplete information, the next time the *coordinating entity* submits a request for *scope certainty* the review shall be undertaken by a *scope review panel*. Paragraph 8 does not prevent the *coordinating entity* from requesting that the *scope review panel* also undertake a review of the Period for which a *scope certainty outcome* was not provided, with payment to the *lead tax administration* of the applicable *tax certainty user fee*. This prevents a Group being permanently denied certainty for a Period by the decision of a single tax administration.

Paragraph 9

618. Paragraph 9 provides that the Conference of the Parties may agree specific arrangements connected with the process for the submission of a request for certainty under Article 22 and the acceptance of a request by the *lead tax administration*, comprising

- a) requirements as to the form and content of a request under Article 22, and
- b) practical steps to be undertaken by a *lead tax administration* in complying with the provisions of the Article.

Article 23 – Requests for certainty by a Covered Group

Paragraph 1

619. Paragraph 1 allows a Group to request *comprehensive certainty* with respect to its application of provisions of the Convention, as set out in its Amount A Tax Return and Common Documentation Package for a Period specified in the request. A request for *comprehensive certainty* must be accompanied by payment to the *lead tax administration* of the relevant *tax certainty user fee*.

620. A request for *comprehensive certainty* under paragraph 1 covers all aspects of Parts II to IV, including the following, where relevant to a particular case. Where a particular aspect is not relevant to a Group for a particular Period, it shall not be covered by a *comprehensive certainty review*.

- a) The definition of a Group.
- b) Whether a Group is a Covered Group for the Period.
- c) The treatment of *disclosed segments*.
- d) The determination and treatment of revenues and costs for purposes of Annex C Section 2 or 3.
- e) The calculation of Adjusted Profit Before Tax.
- f) Application of the autonomous domestic business exemption.
- g) Application of the *defence groups* adjustment.
- h) The categorisation of transactions and choice of *reliable method* for purposes of *revenue sourcing*.
- i) Jurisdiction-level financial statements for the purpose of applying rules on the *marketing and distribution profits safe harbour adjustment* and the Elimination of Double Taxation.
- j) Whether any of the *critical assumptions* agreed as part of an *advance certainty outcome* of the Group are no longer met.
- k) The identification of Parties in which the Group meets the applicable nexus threshold.
- l) The allocation of Amount A Profit to *affected parties*.
- m) The application of the *marketing and distribution profits safe harbour adjustment*.
- n) The Elimination of Double Taxation.

621. Subparagraph (a) provides a general rule that a request shall be submitted at the same time as the Group's Amount A Tax Return and Common Documentation Package for the Period.

622. Where a Group does not submit a request for *comprehensive certainty*, and is subsequently notified that two or more tax administrations of Parties intend to commence a multilateral tax examination of the Group's Amount A Tax Return and Common Documentation Package under the process in Article 31, subparagraph (b) provides that the Group has 30 days from being informed of this fact to submit a *request for comprehensive certainty*. This recognizes the benefit of a consistent application of the Convention by Parties, even when a Group does not initially request *comprehensive certainty*.

623. Subparagraph (c) provides that the Conference of the Parties may agree further deadlines that shall allow a Group to submit a request for *comprehensive certainty* in other circumstances.

624. In order to ensure that a *comprehensive certainty review* is coordinated, both on the part of the Group and on the part of tax administrations, a request should be submitted by the *coordinating entity* of a Group to the *lead tax administration* of that Group.

Paragraph 2

625. Under Paragraph 2, where a Group submits a request for *comprehensive certainty* for a Period, it may at the same time submit a request for *advance certainty* with respect to its application of rules on revenue sourcing in Articles 6 and 7, or aspects of the special rules that apply to Groups that include one or more *regulated financial institutions* and *qualifying extractives groups* in Annex C. A request for *advance certainty* shall also be with respect to aspects of a Group's *internal control framework* relevant to the proposed approach covered by the request. A request for *advance certainty* must be accompanied by payment to the *lead tax administration* of the relevant *tax certainty user fee*.

626. A Group's approach to applying rules on *revenue sourcing* contained in Articles 6 and 7 will be fundamental to the correct application of the Convention for a Period, and this may involve the introduction of new methodologies to collect and present information on a Group's activities in a form that is not currently required for any other purposes. It may also require changes to aspects of a Group's *internal control framework* to ensure these methodologies are being applied correctly and the information provided in a Group's Amount A Tax Return and Common Documentation Package is accurate. This also applies to rules on the application of the Convention to a Group that includes one or more *regulated financial institutions* or a *qualifying extractives group*, for Groups within the scope of those rules. As such, paragraph 2 allows a Group to request certainty that *affected parties* agree in advance the approach that shall be taken by a Group for a Period specified in the request for *advance certainty*, and for a specified number of later Periods subject to conditions, and also that relevant aspects of the Group's *internal control framework* are considered to be designed and operating effectively. Subject to Article 26, Article 29 and Annex F Section 1, an approach covered by an *advance certainty outcome* shall not be considered further as part of a *comprehensive certainty review* for a Period in which that *certainty outcome* applies, reducing the risk of disagreements and increasing the efficiency of the *comprehensive certainty review* process for Groups and *affected parties*.

627. This request should be accompanied by an *advance certainty documentation package*.

Paragraph 3

628. Paragraph 3 includes provisions for a valid request for *comprehensive certainty* or *advance certainty* to be accepted. A valid request is one that is submitted by the deadlines in paragraph 1 and 2, as applicable, which is accompanied by an Amount A Tax Return and Common Documentation Package or *advance certainty documentation package* as relevant, and which meets any requirements agreed by the Conference of the Parties with respect to the format of a request. Payment of the applicable *tax certainty user fee* must also have been made to the *lead tax administration*.

629. Where a request is not in the correct format or is not accompanied by the required documentation, the *lead tax administration* shall require this to be corrected within 60 days, though this may be extended by a further 90 days if the *coordinating entity* explains why more time is needed to make the correction or provide the missing documentation and this is agreed by the *lead tax administration*. Where a corrected request or the missing documentation is not submitted to the *lead tax administration* by this deadline, the *coordinating entity* is considered to have withdrawn its request for certainty.

630. A *comprehensive certainty outcome* resulting from a *comprehensive certainty review* shall be binding on all Parties. Therefore, under subparagraph (a), where a valid request for *comprehensive certainty* is submitted to the *lead tax administration*, the *lead tax administration* shall accept this request on behalf of all Parties, including those that are not *affected parties*.

631. Unlike a *comprehensive certainty outcome*, an *advance certainty outcome* is binding only on *affected parties*. This reflects the fact that an *advance certainty outcome* will apply in a number of Periods, including Periods which will not have commenced when a request is made. Parties which are not *affected parties* shall not be bound by an *advance certainty outcome* in the event they are *affected parties* in a future Period covered by that outcome. As such, under subparagraph (b), where a valid request for *advance certainty* is submitted to the *lead tax administration*, the *lead tax administration* shall accept this on behalf of *affected parties* only. In order to reduce the risk that in a future Period an *affected party* is not bound by an *advance certainty outcome*, a request for *advance certainty* may identify additional *affected parties* for purposes of an *advance certainty review* that are not *affected parties* for purposes of a *comprehensive certainty review* requested at the same time (e.g. where a Group did not have Adjusted Revenues in a Party in the Period to which the request for *comprehensive certainty* relates, but it does have or anticipates that it may have Adjusted Revenues in that Party in a later Period covered by the request for *advance certainty*). The *coordinating entity* should provide an explanation as to the reason for why a Party is included as an *affected party* in a request for *advance certainty*, that was not included as an *affected party* in a request for *comprehensive certainty* submitted at the same time.

632. Following the acceptance of a request for *comprehensive certainty* or a request for *advance certainty*, the Competent Authority of the Party of the *lead tax administration* shall exchange the request, and the *advance certainty documentation package* if relevant, with the Competent Authorities of all *affected parties* by the later of the deadline for the exchange of the Amount A Tax Return and Common Documentation Package (to be agreed by the Competent Authorities of two or more Parties pursuant to Article 37(2)) and 30 days after the request is accepted. By the same deadline it shall also notify the Competent Authorities of all Parties that the request for *comprehensive certainty* has been accepted.

Paragraph 4

633. Paragraph 4 provides a process whereby the Competent Authority of any Party may notify the Competent Authority of the Party of the *lead tax administration* that it considers the Party for which it is Competent Authority to be a Party in which the Group has revenues in excess of the nexus threshold in Article 8. This should be accompanied by documentation sufficient to demonstrate a reasonable basis for this view. Annex F Section 4 includes a list of the types of documentation that may be provided, depending upon the category of revenues in the Party.

634. If the *lead tax administration* agrees that the documentation provided demonstrates a reasonable basis for the view of Competent Authority of the Party, it shall inform the *coordinating entity* that the Party is an *affected party*. Within 15 days of this, all information already exchanged with the Competent Authorities of *affected parties* shall be exchanged with the Competent Authority of that Party.

Paragraph 5

635. Where the Competent Authority of a Party is notified through the process in paragraph 3 that a request for *comprehensive certainty* has been accepted, that Party shall suspend any domestic enquiries that are ongoing, and shall not commence any new enquiries, as to the application of the Convention to Group Entities of that Group with respect to the Period covered by the request. The Party may take the minimum procedural steps required to protect its ability to undertake compliance activity later, such as opening an enquiry on a protective basis, but may not take substantive action such as requesting information from a Group Entity or issuing a tax assessment.

636. Nothing in paragraph 5 shall prevent any Party from collecting tax due in accordance with the Group's Amount A Tax Return and Common Documentation Package. Paragraph 5 also does not prevent

a Party from undertaking enquiries for a Period that is not covered by a request for *comprehensive certainty*, or with respect to matters not covered by the Convention, including *related issues*.

637. The obligation to suspend domestic enquiries under paragraph 5 shall cease to apply in circumstances where the *coordinating entity* notifies the *lead tax administration* that it withdraws its request for *comprehensive certainty*, or is otherwise considered to have withdrawn its request in accordance with Article 30(1).

Paragraph 6

638. Where a Group has submitted a request for *comprehensive certainty* but then has withdrawn that request, or is considered to have done so under Article 30, a further request for *comprehensive certainty* shall not typically be accepted for the same Period.

639. Where a *comprehensive certainty review* was undertaken by the *lead tax administration*, and this review concluded without a *comprehensive certainty outcome* because the *lead tax administration* determined that the *coordinating entity* was persistently late in providing information without explanation or acted in an uncooperative or non-transparent manner, including by providing inaccurate or incomplete information, the next time the *coordinating entity* submits a request for *comprehensive certainty* the review shall be undertaken by a *review panel*. Paragraph 5 does not prevent the *coordinating entity* from requesting that the *review panel* also undertake a review of the Period for which a *comprehensive certainty outcome* was not provided, with payment to the *lead tax administration* of the applicable *tax certainty user fee*. This prevents a Group being permanently denied certainty for a Period by the decision of a single tax administration.

Paragraph 7

640. Paragraph 7 provides that the Conference of the Parties may agree specific arrangements connected with the process for the submission of a request for certainty under Article 23 and the acceptance of a request by the *lead tax administration*, comprising

- a) requirements as to the form and content of a request under Article 23, and
- b) practical steps to be undertaken by a *lead tax administration* in complying with the provisions of the Article,

Article 24 – Conditions for a review by a scope review panel or review panel

Paragraph 1

641. Paragraph 1 describes the circumstances in which a review undertaken subsequent to a request for *scope certainty* shall be undertaken by a *scope review panel* of tax administrations. Where a review is not to be undertaken by a *scope review panel*, it shall be undertaken by the *lead tax administration*. Paragraph 1 includes a number of criteria for a review by a *scope review panel*, in subparagraphs (a) through (g).

642. The criteria in subparagraphs (a) through (c) identify Groups for which a review shall need to consider the application of particular provisions of the Convention. In order for a review to be undertaken by a *scope review panel*, a Group should fall within at least one of these subparagraphs.

- a) Subparagraph (a) covers Groups which, based on information provided by the *coordinating entity*, are a Group that includes one or more *regulated financial institutions* or are a *qualifying extractives group*, and so a review shall consider the rules in Annex C Section 2 or 3.
- b) Subparagraph (b) covers Groups which, based on their Consolidated Financial Statements for the Period or on information provided by the *coordinating entity*, have a *disclosed segment* with reported revenues or Adjusted Revenues in excess of EUR 20 billion and a *pre-tax profit margin* or *segment pre-tax profit margin* in excess of 8 per cent, and so a review shall consider the rules in Annex C Section 4.
- c) Subparagraph (c) covers Groups which have resulted from an *internal fragmentation*, and so a review shall consider Annex C Section 1(7) and (8), including the principal purposes of the *internal fragmentation*.

643. The criteria in subparagraphs (d) through (g) identify the circumstances in which a *scope certainty review* of a Group falling within subparagraphs (a) through (c) shall be undertaken by a *scope review panel*.

- a) Subparagraph (d) provides that a review shall be undertaken the first time that a Group makes a request for *scope certainty* in circumstances where a particular criterion in subparagraphs (a) through (c) is met and this is accepted. For example, if a Group resulted from an *internal fragmentation* in subparagraph (c), a *scope review panel* shall be established to undertake a review the first time that the Group submits a request for *scope certainty*. If in a later year the Group becomes a *qualifying extractives group*, a *scope review panel* shall also be established the next time the Group submits a request for *scope certainty*, as this will be the first time it has submitted a request as a Group to which subparagraph (a) applies.
- b) Under subparagraph (e), where a Group has previously requested *scope certainty*, but a *scope certainty outcome* was never agreed as the Group was persistently late in providing information, acted in an uncooperative or non-transparent manner, or withdrew its request for *scope certainty* before an outcome was reached, a *scope review panel* shall be established the next time the Group requests *scope certainty*. This ensures that the first full *scope certainty review* of a Group in subparagraphs (a) through (c) is undertaken by a *scope review panel*.
- c) Where subparagraph (e) does not apply (i.e. where a *scope certainty outcome* for the Group has been agreed for an earlier Period), subparagraph (f) provides that, if the most recent *scope certainty review* requested by the Group ended without a *scope certainty outcome* because the Group was persistently late in providing information, or acted in an uncooperative or non-transparent manner, the next *scope certainty review* for that Group shall be undertaken by a *scope review panel*.
- d) Subparagraph (g) provides that, in any case, a *scope review panel* shall be established to undertake a *scope certainty review* where there is a Period of at least seven years between the first day of the last Period for which a review was undertaken by a *scope review panel* and the first day of the Period for which *scope certainty* is requested, if a *scope review panel* is proposed by the *lead tax administration* or by any *listed party*. This ensures that a *scope review panel* shall be established every seven years where in the view of the *lead tax administration* or any *listed party* such a panel is necessary, but a *scope review panel* is not required where neither the *lead tax administration* nor any *listed party* considers one to be needed. Where no proposal for a *scope review panel* is made in accordance with subparagraph (g), this subparagraph would also allow a *scope review panel* to be proposed

for a subsequent Period if a Group made a request for *scope certainty* and a *listed party* considered a *scope review panel* to be needed.

Paragraph 2

644. Under paragraph 2, a *scope advance certainty review* shall always be undertaken by a *scope review panel*.

Paragraph 3

645. Paragraph 3 describes the circumstances in which a review undertaken subsequent to a request for *comprehensive certainty* shall be undertaken by a *review panel* of tax administrations. Where a review is not to be undertaken by a *review panel*, it shall be undertaken by the *lead tax administration*.

646. Paragraph 3 includes a number of criteria for a review by a *review panel*, in subparagraphs (a) through (d). A *review panel* shall be established where any of these criteria are met.

- a) Subparagraph (a) provides that a review shall be undertaken by a *review panel* the first time that a Group makes a request for *comprehensive certainty* and this is accepted.
- b) Under subparagraph (b), where a Group has previously requested *comprehensive certainty*, but a *comprehensive certainty outcome* was never agreed as the Group was persistently late in providing information, acted in an uncooperative or non-transparent manner, or withdrew its request for *comprehensive certainty* before an outcome was reached, a *review panel* shall be established the next time the Group requests *comprehensive certainty*. This ensures that the first full *comprehensive certainty review* of a Group is undertaken by a *review panel*.
- c) Where subparagraph (b) does not apply (i.e. where a *comprehensive certainty outcome* for the Group has been agreed for an earlier Period), subparagraph (c) provides that, if the most recent *comprehensive certainty review* requested by the Group ended without a *comprehensive certainty outcome* because the Group was persistently late in providing information, or acted in an uncooperative or non-transparent manner, the next *comprehensive certainty review* for that Group shall be undertaken by a *review panel*.
- d) Subparagraph (d) includes a number of circumstances in which a *review panel* can be proposed by the *lead tax administration* or any *affected party*. For a *review panel* to be required under this subparagraph, one of the criteria in subdivision (i), (ii) or (iii) must be met, and one of the criteria in subdivision (iv) or (v) must be met.
 - i) Subdivision (i) applies where there is a Period of at least five years between the first day of the last Period for which a review was undertaken by a *review panel* and the first day of the Period to which the request for *comprehensive certainty* relates. This ensures that in all cases there is a maximum period that can elapse between *review panels*, subject to subdivision (iv) or (v) being satisfied.
 - ii) Subdivision (ii) includes a number of alternative circumstances in which a *review panel* may be proposed, based on information contained in a Group's Amount A Tax Return and Common Documentation Package for the Period.
 - A) A minimum of 10 per cent of the Group's Amount A Profit is allocated to Parties that were not *affected parties* for the most recent Period for which a

comprehensive certainty review was undertaken by a *review panel*, or a minimum of 10 per cent of the obligation to provide relief for Amount A taxation is allocated to Parties that were not *affected parties* for the most recent Period for which a *comprehensive certainty review* was undertaken by a *review panel*.

- B) A minimum of 10 per cent of the *affected parties* to which Amount A Profit is allocated were not *affected parties* for the most recent Period for which a *comprehensive certainty review* was undertaken by a *review panel*, or a minimum of 10 per cent of the *affected parties* which provide relief for Amount A taxation were not *affected parties* for the most recent Period for which a *comprehensive certainty review* was undertaken by a *review panel*.
 - C) It is the first Period for which the Group is a *qualifying extractives group* or a Group that includes one or more *regulated financial institutions*.
- iii) Subdivision (iii) applies where the immediately preceding time a Group requested *comprehensive certainty* the review was carried out by the *lead tax administration*, on the basis of information contained in the Group's Amount A Tax Return and Common Documentation Package for that Period none of the conditions in subdivision (ii) were met, but based on the approach contained in the *comprehensive certainty outcome* agreed as a result of that review, one of those conditions was met. In effect, this means that where the conditions in subdivision (ii) are not met based on the information provided by a *coordinating entity*, but they are met based on the approach agreed through a *comprehensive certainty review*, a *review panel* can be required the next time the *coordinating entity* submits a request for *comprehensive certainty*.
 - iv) Where any of the criteria in subdivision (i), (ii) or (iii) are met, the *lead tax administration* can propose that the *comprehensive certainty review* be undertaken by a *review panel* under subdivision (iv).
 - v) Where the *lead tax administration* does not make such a proposal, then a *review panel* to undertake the review can be proposed by any *affected party* under subdivision (v). This ensures that a *review panel* shall be established every five years and in other objective circumstances where the *lead tax administration* or any *affected party* thinks such a panel is necessary, but a *review panel* is not required where neither the *lead tax administration* nor any *affected party* considers one to be needed. Where no proposal for a *review panel* is made at the end of five years, paragraph 3 would also allow a *review panel* to be proposed for a subsequent Period if a Group made a request for *comprehensive certainty* and an *affected party* considered a *review panel* to be needed.

Paragraph 4

647. Under paragraph 4, an *advance certainty review* shall always be undertaken by a *review panel*.

Article 25 – Constitution of a scope review panel or review panel

648. Article 25 includes a number of rules concerning the constitution of a *scope review panel* or *review panel* to undertake a review requested under Article 22 or 23. Paragraph 8 directs the Conference of the

Parties to agree a process to identify members of a panel in accordance with this Article from the tax administrations of *listed parties* or *affected parties* that express interest in participating.

649. In all cases, a *listed party* or *affected party* should only express interest in participating on a *scope review panel* or *review panel* if its tax administration is committed to taking an active role on the panel and applying sufficient resources to ensure this is possible.

Paragraph 1

650. Paragraph 1 provides a general rule that where a *scope review panel* is established to undertake a *scope certainty review*, the panel shall comprise the *lead tax administrations* and six other tax administrations chosen at random from *listed parties* that submit an expression of interest to participate on the panel.

Paragraphs 2 and 3

651. Paragraph 2 contains an exception to the general rule in paragraph 1. Under this paragraph, where a *scope review panel* is established to undertake a *scope certainty review* or *scope advance certainty review* of a *qualifying extractives group* or a Group that includes one or more *regulated financial institutions*, the constitution of the panel shall be adjusted.

652. Where a Group is a *qualifying extractives group*, the *scope review panel* shall include the *lead tax administration*, three tax administrations from *listed parties* in which the Group has a license in effect to explore for or exploit *minerals*, *mineraloids* or *hydrocarbons*, and three tax administrations from other *listed parties*, chosen at random from the tax administrations of *listed parties* that expressed interest within each category.

653. Where a Group includes one or more *regulated financial institutions*, the *scope review panel* shall include the *lead tax administration*, three tax administrations from *listed parties* in which the Group has employee headcount in *regulated financial institutions* which amounts to at least 5 per cent of total headcount in all of the Group's *regulated financial institutions*, and three tax administrations from other *listed parties*, chosen at random from the tax administrations of *listed parties* that expressed interest within each category.

654. Where a *scope review panel* is established under paragraph 2, and the process agreed by the Conference of the Parties to identify members of a *scope review panel* means that one or more places on the panel within a particular category of tax administrations remain empty, these places shall be allocated to the tax administrations of other *listed parties* that expressed interest in participating on the panel, chosen at random.

Paragraph 4

655. To improve efficiency, paragraph 4 provides that a where a *coordinating entity* submits at the same time a request for *scope certainty* and for *scope advance certainty*, and a *scope certainty panel* is to be established under paragraph 2 to undertake the *scope certainty review*, both the *scope certainty review* and the *scope advance certainty review* shall be undertaken by the same panel.

Paragraphs 5 and 6

656. Under paragraph 5, where a *review panel* is established to undertake a *comprehensive certainty review* or *advance certainty review*, the panel shall include the *lead tax administration*, three tax

administrations from *affected parties* required to provide relief for Amount A taxation, selected at random from those within this category (based on information contained in the Group's Amount A Tax Return and Common Documentation Package) that expressed interest in participating on the panel, and three tax administrations from other *affected parties* that expressed interest in participating on the panel.

657. The three tax administrations from other *affected parties* shall to the extent possible include one tax administration from an *affected party* that is a *specified low- or middle-income jurisdiction*, one tax administration from an *affected party* that is not a *specified low- or middle-income jurisdiction economy*, and one tax administration from an *affected party* without reference to whether it is a *specified low- or middle-income jurisdiction*. In each case, the members of the *review panel* shall be chosen at random from the tax administrations of *affected parties* that meet the relevant criteria. For these purposes, a *specified low- or middle-income jurisdiction* is one which is classified by the World Bank as a low- or middle-income economy using the World Bank Atlas Method, based on the most recent publicly available data released by the World Bank prior to the first day of the Period for which certainty is requested, excluding members of the OECD and G20.

658. Where a *review panel* is established under paragraph 5, and the process agreed by the Conference of the Parties to identify members of a *review panel* means that one or more places on the panel within a particular category of tax administrations remain empty, paragraphs 5 and 6 include a process for these places to be allocated to the tax administrations of *affected parties* in other categories that expressed interest in participating on the panel, chosen at random.

Paragraph 7

659. To improve efficiency, paragraph 7 provides that a where a *coordinating entity* submits at the same time a request for *comprehensive certainty* and for *advance certainty*, a *review panel* is to be established under paragraph 5 to undertake the *comprehensive certainty review*, and the *affected parties* for purposes of both reviews are the same, the *comprehensive certainty review* and the *advance certainty review* shall be undertaken by the same panel.

Article 26 – Certainty review

Paragraph 1

660. Paragraph 1 provides a basis for a *scope certainty review* or *follow-up scope certainty review* in accordance with Article 37, where a request is accepted under Article 22. Subject to the process described in Annex F Section 1, a review shall be based on information contained in the *scope certainty documentation package* or *follow-up scope certainty documentation package* filed with a request to determine whether a Group is a Covered Group for the Period, or if it continues not to be a Covered Group. Unless a request for certainty is withdrawn or considered to be withdrawn under Article 30, a review shall conclude with a *scope certainty outcome*.

Paragraph 2

661. Paragraph 2 provides a basis for a *comprehensive certainty review* in accordance with Article 37, where a request is accepted under Article 23. Subject to the process described in Annex F Section 1, a review shall be based on information contained in the Amount A Tax Return and Common Documentation Package to determine whether this reflects a correct application of the Convention to the Group for a Period or if changes are required.

662. Where a *coordinating entity* previously requested *scope certainty* or *follow-up scope certainty* for the same Period, and the subsequent review concluded with an agreed *scope certainty outcome*, an *affected party* for purposes of the *comprehensive certainty review* (including a member of a *review panel*) should not propose changes to the Group's Amount A Tax Return and Common Documentation Package that are inconsistent with that *scope certainty outcome*, if it was a *listed party* for purposes of the earlier review, unless this is necessary for the correct application of the Convention. In circumstances where this is necessary, this should be explained.

Paragraph 3

663. Paragraph 3 provides a basis for a *scope advance certainty review* or *advance certainty review* in accordance with Article 37, where a request is accepted under Article 22 or 23. Subject to the process described in Annex F Section 1, a review shall be based on information contained in the *advance certainty documentation package*, to determine whether the proposed approaches contained in that package reflect a correct application of the Convention or if changes are required.

664. The *critical assumptions* underpinning a Group's proposed approach are fundamental to an *advance certainty outcome* agreed following a review, as that outcome ceases to apply where one or more *critical assumptions* is not met or is no longer met. As such, an important part of a review will be the development by a *scope review panel* or *review panel* of the list of *critical assumptions* to be agreed by *listed parties* or *affected parties*. This shall begin with, but is not limited to, *critical assumptions* proposed by the *coordinating entity* in the *advance certainty documentation package*. Typically, a list of *critical assumptions* for purposes of an *advance certainty outcome* should not include an assumption that there has been no material change in a Group's financial results.

Paragraph 4

665. Paragraph 4 provides that where a review includes one or more of the matters listed in Article 22(2) or 23(2), a *scope review panel*, *review panel* or *lead tax administration* may undertake a review of aspects of a Group's *internal control framework* relevant to these matters and, where required, identify and recommend improvements to these aspects of the framework. A review of aspects of a Group's *internal control framework* shall typically be required as part of a *scope advance certainty review* or *advance certainty review*. It may also be needed as part of a *scope certainty review* or *comprehensive certainty review*, if an *advance certainty outcome* does not apply to the Period in question.

666. To the extent a matter requires the use of information taken from a Group's financial statements and this information has been subject to independent audit, no changes shall be required to aspects of an *internal control framework* responsible for ensuring the accuracy of this information. Where the Convention requires information that is not taken from a Group's financial statements, where information has not been audited, or where information taken from a Group's audited financial statements is subject to adjustment or is used in undertaking calculations for the purpose of applying the Convention, a review may include aspects of a Group's *internal control framework* responsible for ensuring the accuracy of this information, these adjustments and these calculations to determine whether they can be relied upon or whether different or additional controls are needed. A review shall not include any other aspects of a Group's *internal control framework*. The fact that the same controls are used by a Group to ensure the accuracy of information prepared for a different purpose may provide comfort to a *scope review panel*, *review panel* or *lead tax administration*, but does not necessarily mean those controls are appropriate for purposes of Amount A. The Conference of the Parties may agree mechanisms for an opinion or other evidence of work undertaken or provided by the Group's independent auditors or advisers to be taken into account in undertaking a review, but a *scope review panel*, *review panel* or *lead tax administration* shall not be bound by such an opinion or evidence. Where a *scope review panel*, *review panel* or *lead tax administration* does not agree

that an element of the Group's *internal control framework* covered by a review is currently designed and operating effectively, it shall identify a combination of improvements to that framework which, if implemented by the Group, would address this and recommend that these improvements be required. These required improvements should not require any changes to the Group's existing framework beyond those which are needed for the relevant aspect to be considered to be designed and operating effectively.

Paragraphs 5 through 9

667. Paragraphs 5 through 9 set out the process for a *certainty review* to give rise to a *certainty outcome* where there is agreement between *listed parties* or *affected parties*, including those on a *scope review panel* or *review panel*.

668. Paragraphs 5, 6 and 8 concern scenarios where the outcomes of a review do not require any changes to the approach taken in the Group's Amount A Tax Return and Common Documentation Package or other documentation package filed by the *coordinating entity* with its request for certainty under Article 22 or 23. Where a *comprehensive certainty review* is undertaken in phases and the final phase has not yet been undertaken, the review shall move to the next phase. Otherwise, in these scenarios a review ends directly with a *scope certainty outcome*, *comprehensive certainty outcome* or *advance certainty outcome* as applicable. The consequence of each *certainty outcome* is described in Article 29.

669. Paragraphs 7 and 9 concern scenarios where the outcomes of a *comprehensive certainty review*, *scope advance certainty review* or *advance certainty review* requires changes to the Amount A Tax Return and Common Documentation Package or *advance certainty documentation package* filed by the *coordinating entity*. In these scenarios, the *lead tax administration* shall require the *coordinating entity* to submit a revised documentation package within 90 days reflecting these required changes. Where a *comprehensive certainty review* is undertaken in phases and the final phase has not yet been undertaken, the review shall move to the next phase. In this case, the *review panel* may agree or, if a *review panel* was not established, the *lead tax administration* may decide that a revised Amount A Tax Return and Common Documentation Package shall only be required after completion of the final phase of the review, reflecting specified changes required in all phases. The Conference of the Parties may agree an approach for the *scope review panel*, *review panel* or *lead tax administration* to ensure that all required changes have been correctly reflected in the revised documentation package provided by the *coordinating entity*. Once all required changes have been reflected in a revised documentation package, the review ends with a *comprehensive certainty outcome* or *advance certainty outcome* as applicable. The consequence of each *certainty outcome* is described in Article 29.

670. The revised Amount A Tax Return and Common Documentation Package required in paragraph 7 ensures that the *lead tax administration* and all *affected parties* have access to the same documentation containing a common application of the Convention reflecting any changes required as a result of the *comprehensive certainty review*, for the purpose of implementing any changes under Article 29(3). Similarly, the revised *advance certainty documentation package* required in paragraph 9 ensures that the *lead tax administration* and all *listed parties* or *affected parties* have access to the same documentation containing a common description of the approach agreed to the matters in Article 22(2) or 23(2) covered by the *scope advance certainty review* or *advance certainty review*, including any changes to the Group's proposed approach or *internal control framework* required as a result of that review.

Paragraph 10

671. Paragraph 10 provides for a *scope review panel*, *review panel* or *lead tax administration* to develop processes for undertaking a review so long as these are not inconsistent with the Convention or any arrangement agreed by the Conference of the Parties. This allows tax administrations undertaking a review

flexibility in how the review will be undertaken in practice, while ensuring that any requirements or restrictions set out in the Convention and any arrangements agreed by the Conference of the Parties continue to apply.

Paragraph 11

672. Paragraph 11 includes a number of matters which may be agreed by the Conference of the Parties, included in subparagraphs (a) through (d).

673. Subparagraph (a) concerns the date upon which a review shall be considered to have commenced. Given the strict limits on the time available to complete a review provided in Annex F, an agreed approach as to when a review commences will be important to ensure that certainty is provided in accordance with the timeframe envisaged in the Convention.

674. Subparagraph (b) concerns procedures to be followed during a review by a *scope review panel*, *review panel* or *lead tax administration*. Clarity over these procedures, which may be refined and revised by the Conference of the Parties as experience in undertaking reviews increases, will be valuable in ensuring the efficiency of reviews, and consistency in the approach taken with respect to the same issues in reviews by different panels, as well as an understanding as to when a different approach to a particular issue may be appropriate depending upon the facts of a case.

675. Subparagraph (c) concerns arrangements for members of a *scope review panel*, *review panel* or the *lead tax administration* to consult with tax officials of other *listed parties* or *affected parties* where this is considered necessary. This may include, but is not limited to, the establishment of pools of tax officials with expertise on topics relevant to a review, which may be technical skills, sector-specific experience (e.g. which may be relevant to a review of a Group's revenue sourcing approach or the application of rules on *qualifying extractives groups* or Groups including one or more *regulated financial institutions*), or experience in undertaking a particular type of review (e.g. of a group's *internal control framework*). Subparagraph (c) is not prescriptive as to these topics, as the areas where skills and experience required to undertake a review may not be present in tax administrations of all Parties such that consultation would be beneficial, as well as the most effective processes for such a consultation, are likely to be clearer once the tax administrations of Parties gain experience in undertaking reviews under the Convention. In all cases, a tax official supporting a review would be from a tax administration that is a *listed party* or *affected party*, and would be subject to strict rules on confidentiality under Article 37.

676. Subparagraph (d) concerns an approach whereby a *comprehensive certainty review* may be undertaken following a phased approach. Flexibility for a *review panel* or *lead tax administration* to progress to the next phase of a review directly, or to identify and resolve disagreements before progressing, shall ensure that a process to resolve disagreements that may impact a later phase of a review is available when needed, but this process shall not delay a *certainty outcome* for a Covered Group where it is not needed.

Paragraph 12

677. Paragraph 12 provides that the provisions of Annex F Section 1 apply for the purpose of applying Article 26. See the explanation of Annex F for further explanation of those provisions.

Article 27 – Determination panel to resolve disagreements

Paragraph 1

678. Paragraph 1 contains a general provision that where a request for certainty is accepted under Article 22(3) or 23(3), and there are one or more issues where there is disagreement following the review under Article 26, these issues shall be resolved by a *determination panel*. This ensures that any disagreements arising in the course of a *scope certainty review*, *follow-up scope certainty review*, *scope advance certainty review*, *comprehensive certainty review* or *advance certainty review* shall be resolved.

Paragraph 2

679. Paragraph 2 includes a process to ensure that all *affected parties* and *listed parties* have an opportunity to consider and comment on all issues where there is disagreement that shall be presented to the *determination panel*.

680. A review under Article 26 ends at the deadline for written comments under Annex F Section 1(30) or (31), or the end of the consultation process under Annex F Section 1(35), if relevant. Within 30 days of the end of such a review, the Competent Authority of the Party of the *lead tax administration* shall exchange with the Competent Authorities of all *listed parties* or *affected parties* a list of the issues where there is disagreement, a description of the alternative outcomes that have been proposed to address each issue, details of the position of each member of the *scope review panel*, *review panel* or *lead tax administration*, and the *listed party* or *affected party* that submitted written comments (if applicable) as well as any written explanation provided by the *coordinating entity* as to its approach to the relevant issue.

681. A Competent Authority *may* within 90 days provide comments to the Competent Authority of the Party of the *lead tax administration*, supporting or disagreeing with any of the alternative outcomes to the issues, and may also provide a paper explaining its position. Where a number of alternative outcomes have been proposed with respect to a particular issue, and a Competent Authority considers more than one of these alternative outcomes to be an acceptable application of the Convention, then the Competent Authority may express support for more than one alternative outcome, or may support one alternative outcome but indicate it considers some of the other alternative outcomes to reflect an acceptable application of the Convention.

682. Within 30 days of the deadline for written comments, the Competent Authority of the Party of the *lead tax administration* shall exchange all of these comments and papers with the Competent Authorities of all *listed parties* or *affected parties*. This ensures that all *listed parties* and *affected parties* are aware of the positions of all other *listed parties* and *affected parties*, and have access to the information that will be provided to a *determination panel*.

Paragraph 3

683. Paragraph 3 includes a list of the information and documentation that shall be provided to members of a *determination panel* for the purpose of considering the issues put to it for resolution. This includes any written explanation provided by the *coordinating entity* with respect to its approach to an issue where there is disagreement. However, where the approach taken by the *coordinating entity* is not one of the alternative outcomes supported by members of a *scope review panel* or *review panel*, or by the *lead tax administration* or one or more *listed parties* or *affected parties*, then this approach is not one of the alternative outcomes that the *determination panel* may choose from.

Paragraphs 4 through 7

684. The *determination panel* process is a fundamental aspect of the *tax certainty framework*, as it assures resolution of all disagreements and the provision of certainty for Groups that request it and act in a cooperative and transparent manner.

685. The *determination panel* shall resolve disagreements by choosing between the alternative outcomes put to it. The *determination panel* shall not develop alternative outcomes that are not put to it to choose from and shall not comment on any issue that is not referred to it for resolution.

686. The *determination panel* may request clarification of the issues or alternative outcomes put to it but may not request any additional information that would need to be obtained from the *coordinating entity* or Group Entities.

687. Where two or more issues referred to the *determination panel* for resolution rely on the interpretation or application of the same provisions of the Convention, these issues may be grouped by the Chair and considered together to facilitate an efficient process and consistency in outcomes. This does not mean that the *determination panel* is required to reach the same decision on these issues, if *determination panel* members agree that the particular fact pattern concerning each issue mean that different decisions are not inconsistent.

688. *Determination panel* members should endeavour to reach a decision as to the alternative outcome that should be chosen on each issue by *consensus*. Where this is not possible, the Chair of the *determination panel* shall use the process described in Annex F Section 2 to identify the alternative outcome chosen by the *determination panel*. It is left to the discretion of the Chair as to how long should be spent discussing issues before concluding that reaching a decision by *consensus* is not possible, depending upon the complexity of the issues being discussed, the level of disagreement between *determination panel* members, and the limit on the number of days for which *determination panel* members shall be compensated for their time under Annex F Section 3.

689. A *determination panel* shall resolve all issues referred to it within 90 days, and shall deliver its decisions to the *lead tax administration* as a single compilation. Where the same *determination panel* is required to resolve issues with respect to different phases of a review, or with respect to reviews for more than one Period, the panel's decisions shall be included in different compilations that correspond with these phases or Periods.

Paragraph 8

690. Paragraphs 8 sets out the process for a *certainty review* to give rise to a *certainty outcome* where there are issues which have been resolved by a *determination panel*.

691. Subparagraphs (a), (b) and (d) concern scenarios where the outcomes of a review, including the decisions of the *determination panel*, do not require any changes to the approach taken in the Group's Amount A Tax Return and Common Documentation Package or other documentation package filed by the *coordinating entity* with its request for certainty under Article 22 or 23. Where a *comprehensive certainty review* is undertaken in phases and the final phase has not yet been undertaken, the review shall move to the next phase. Otherwise, in these scenarios a review ends directly with a *scope certainty outcome*, *comprehensive certainty outcome* or *advance certainty outcome* as applicable. The consequence of each *certainty outcome* is described in Article 29.

692. Subparagraphs (c) and (e) concern scenarios where the outcomes of a *comprehensive certainty review*, *scope advance certainty review* or *advance certainty review*, including the decisions of the *determination panel*, requires changes to the Amount A Tax Return and Common Documentation Package or *advance certainty documentation package* filed by the *coordinating entity*. In these scenarios, the *lead tax administration* shall require the *coordinating entity* to submit a revised documentation package within 90 days reflecting these required changes. Where a *comprehensive certainty review* is undertaken in phases and the final phase has not yet been undertaken, the review shall move to the next phase. In this case, the *review panel* may agree or, if a *review panel* was not established, the *lead tax administration* may decide that a revised Amount A Tax Return and Common Documentation Package shall only be required after completion of the final phase of the review, reflecting specified changes required in all phases. The Conference of the Parties may agree an approach to ensure that all required changes have been correctly reflected in the revised documentation package provided by the *coordinating entity*. Once all required changes have been reflected in a revised documentation package, the review ends with a *comprehensive certainty outcome* or *advance certainty outcome* as applicable. The consequence of each *certainty outcome* is described in Article 29.

693. The revised Amount A Tax Return and Common Documentation Package required in subparagraph (c) ensures that the *lead tax administration* and all *affected parties* have access to the same documentation containing a common application of the Convention reflecting any changes required as a result of the *comprehensive certainty review*, for the purpose of implementing any changes under Article 29(3). Similarly, the revised *advance certainty documentation package* required in subparagraph (e) ensures that the *lead tax administration* and all *listed parties* or *affected parties* have access to the same documentation containing a common description of the approach agreed to the matters in Article 22(2) or 23(2) covered by the *scope advance certainty review* or *advance certainty review*, including any changes to the Group's proposed approach or *internal control framework* required as a result of that review.

Article 28 – Composition of a determination panel

Paragraph 1

694. Article 28 sets out basic rules for the composition of a *determination panel*. Paragraph 1 states that the *determination panel* is composed of seven individual panel members. These seven panel members would comprise three *independent experts*, three *government officials* and a Chair. The terms *independent experts* and *government officials*, in this context, draw their meaning from Annex F Section 3(2) and (3) respectively. Paragraph 1(a) provides that the three *independent experts* shall be chosen by random selection from all *independent experts* in the *standing pool*, who are not conflicted to act in such capacity. Annex F Section 3(1) provides the definition of the *standing pool* in this regard. In addition, Annex F Section 3(14) provides the definition of individuals that are conflicted to act in a *determination panel*.

695. Paragraph 1(b) follows the structure of the composition of the *review panel* under Article 25 with respect to the three *government officials* and provides that the selection of these *government officials* depends on whether the *determination panel* has been created to resolve disagreements arising in a *scope certainty review* or *follow-up scope certainty review* or for other reviews. For *determination panels* that arise from *scope certainty reviews* or *follow-up scope certainty reviews*, paragraph 1(b)(i) provides that the three *government officials* would comprise:

- one *government official* nominated by the Party of the *lead tax administration*;

- one *government official* nominated by a Party chosen by random selection from *listed parties* (excluding the Party of the *lead tax administration*) where, based on information provided by the Group:
 - the Group has a license in effect to explore for or exploit *minerals, mineraloids or hydrocarbons* if that Group is seeking to apply the exclusion for Adjusted Revenues derived from the sale of *extractive products*; or
 - the Group has an employee headcount in *regulated financial institutions* which amounts to at least 5 per cent of total headcount in all the Group's *regulated financial institutions* for a Group including one or more *regulated financial institutions*; and
- one *government official* nominated by a Party chosen by random selection from the *listed parties*, excluding the Party of the *lead tax administration* or Parties included in the second category above. However, if there are no Parties in the second category above, two *government officials* would be selected in this category

696. For *determination panels* that arise from all other reviews, paragraph 1(b)(ii) provides that the three *government officials* would comprise:

- One *government official* nominated by the Party of the *lead tax administration*;
- One *government official* nominated by a Party chosen by random selection from the *affected parties* required to provide relief for Amount A taxation with respect to the *relevant group* for the Period based on the information contained in the Amount A Tax Return and Common Documentation Package, which expressed interest to participate in the *determination panel*, excluding the Party of the *lead tax administration*; and
- One *government official* nominated by a Party chosen by random selection from the *affected parties* in which the *relevant group* meets the nexus threshold under Article 8 for the Period, based on the information contained in the Amount A Tax Return and Common Documentation Package, which expressed interest to participate in the *determination panel*, excluding the Party of the *lead tax administration* or Parties included in the second category above.

697. Where there are no *affected parties* covered in the second category above (owing to for example, the *lead tax administration* being the only Jurisdiction required to provide relief for Amount A taxation with respect to the *relevant group* for the Period based on the information contained in the Amount A Tax Return and Common Documentation Package), paragraph 1(b)(ii) also provides that the Secretariat of the Conference of the Parties shall invite Parties other than *affected parties* to submit an expression of interest for a *government official* nominated by such Party to participate in the *determination panel* within 30 days. This unfilled seat shall be filled by random selection from among Parties expressing interest. Where no other Parties have expressed interest, the number of *government officials* in the third category above would be increased from one to two instead. It is clarified that references to the "Secretariat of the Conference of the Parties" in this Article as well as in Annex F Section 3, are as defined in Article 47(7). The Party of the *lead tax administration* should ensure that all necessary information is shared with the Secretariat of the Conference of the Parties sufficiently in advance to allow it to perform its functions under these provisions within the prescribed deadlines.

698. Paragraph 1(c) provides that the Chair would be chosen by *consensus* among the six previously selected *independent experts* and *government officials*. It is also noted that the Chair could either be an *independent expert* from the *standing pool*, who is not conflicted to act in such capacity or a *government*

official who does not work for or on behalf of Parties already represented in the *determination panel*. Where the six previously selected panellists are not able to reach *consensus* within 30 days from the selection of the sixth and final panellist, the Chair shall be chosen by random selection from among the *independent experts* in the *standing pool* who are not conflicted to act in such capacity.

Paragraph 2

699. Paragraph 2 details how expressions of interest would be obtained for *government officials* that would act in a *determination panel*. The Secretariat of the Conference of the Parties shall invite from *listed parties* (for *determination panel* arises from a *scope certainty review* or *follow-up scope certainty review*) or *affected parties* (for other reviews) to submit an expression of interest for a *government official* nominated by such Party to participate in the *determination panel* within 60 days of the date on which the Competent Authority of the Party of the *lead tax administration* exchanges with the Competent Authorities of all *listed parties* or *affected parties* a list of all issues where there is disagreement under Article 27(2). The Competent Authority of the Party of the *lead tax administration* should provide details of the Parties concerned to the Secretariat of the Conference of the Parties and inform it sufficiently in advance of this list being shared to ensure that the Secretariat of the Conference of the Parties is in a position to launch a call for expressions of interest under paragraph 2 on the same date as the list being shared. Paragraph 2 also notes that a Party should only express interest in participating in a *determination panel* if the person nominated by it is committed to taking an active role on the *determination panel* and the *listed party* or *affected party* concerned would make available sufficient resources to ensure this is possible.

Paragraph 3

700. Paragraph 3 provides that the provisions of Annex F Section 3 would be applicable with respect to Article 28 since as noted above, several operative and procedural elements on the composition of the *determination panel* are detailed therein. To this extent, Article 28 should always be read together with this provision with relation to how the composition of the *determination panel* should be established for each individual case.

Article 29 – Certainty outcomes

Paragraph 1

701. Paragraph 1 concerns the outcomes of a *scope certainty review*. Where a *coordinating entity* has submitted a request for *scope certainty* and this is not withdrawn, the *scope certainty review* shall end with an agreed *scope certainty outcome* which shall contain a decision as to whether the Group is a Covered Group for the Period covered by the review.

702. Where the *scope certainty outcome* includes a decision that the Group is not a Covered Group for the Period, no action is required. The suspension of compliance activity under Article 22(6) with respect to the Period to which the *scope certainty outcome* relates shall continue to apply. Unless at any point the *coordinating entity* is considered to have withdrawn its request for certainty under Article 30, the *scope certainty outcome* shall continue to apply in all *listed parties*.

703. Where the *scope certainty outcome* includes a decision that the Group is a Covered Group for the Period, the *coordinating entity* shall be required to file an Amount A Tax Return and Common Documentation Package with the *lead tax administration*. This should be filed within 180 days of the *coordinating entity* being notified of the *scope certainty outcome*, unless the usual filing deadline is later

than this, in which case the usual filing deadline shall apply. If the *coordinating entity* does not file an Amount A Tax Return and Common Documentation Package by this deadline, the suspension of compliance activity under Article 22(6) shall cease to apply. The filing deadline for the Amount A Tax Return and Common Documentation Package in Article 14 and the payment deadline in Article 16 (or under the domestic law of a Party where that Article does not apply) shall apply for the purpose of determining, for example, administrative penalties, interest or other amounts imposed under the domestic law of a Party.

Paragraph 2

704. Paragraph 2 concerns the outcomes of a *follow-up scope certainty review*. Where a *coordinating entity* has submitted a request for *scope certainty* in circumstances where Article 22(7) applies and this is not withdrawn, the *follow-up scope certainty review* shall end with an agreed *scope certainty outcome* which shall either contain a decision that the Group continues not to be a Covered Group in the Period covered by the review, or a conclusion that it cannot be agreed that the Group continues not to be a Covered Group on the basis of the information available.

705. Where the *scope certainty outcome* includes a decision that the Group continues not to be a Covered Group in the Period, no action is required. The suspension of compliance activity under Article 22(6) with respect to the Period to which the *scope certainty outcome* relates shall continue to apply. Unless at any point the *coordinating entity* is considered to have withdrawn its request for certainty under Article 30, the *scope certainty outcome* shall continue to apply in all *listed parties*.

706. Where a *scope certainty outcome* includes a decision that it cannot be agreed that the Group continues to be a Covered Group, the *coordinating entity* may within 90 days file an amended request for *scope certainty* with the *lead tax administration*, together with any documentation agreed by the Conference of the Parties. As this is an amendment to an existing request for *scope certainty*, it is not subject to the deadlines in Article 25(1). If the *coordinating entity* does not submit an amended request for *scope certainty* by this date, it shall be required to file an Amount A Tax Return and Common Documentation Package with the *lead tax administration*. This should be filed within 180 days of the *coordinating entity* being notified of the *scope certainty outcome*, unless the usual filing deadline is later than this, in which case the usual filing deadline shall apply. If the *coordinating entity* does not file an Amount A Tax Return and Common Documentation Package by this deadline, the suspension of compliance activity under Article 22(6) shall cease to apply. The filing deadline for the Amount A Tax Return and Common Documentation Package in Article 14 and the payment deadline in Article 16 (or under the domestic law of a Party where that Article does not apply) shall apply for the purpose of determining, for example, administrative penalties, interest or other amounts imposed under the domestic law of a Party.

Paragraphs 3 and 4

707. Paragraphs 3 and 4 concern the outcomes of a *comprehensive certainty review*. Where a *coordinating entity* has submitted a request for *comprehensive certainty* and this is not withdrawn, the *comprehensive certainty review* shall end with an agreed *comprehensive certainty outcome* which shall either contain a decision which agrees with the application of the Convention in the Group's Amount A Tax Return and Common Documentation Package for the Period or shall require specified changes to these documents.

708. Where an agreed *comprehensive certainty outcome* requires changes to the application of the Convention contained in a Group's Amount A Tax Return and Common Documentation Package for a Period, subparagraph (b) provides that these changes shall be implemented by *affected parties*

notwithstanding any time limits in domestic law. Processes to implement these changes, including any agreed deadline, may be agreed by the Conference of the Parties under paragraph 11.

709. Where a *comprehensive certainty outcome* is agreed, the suspension of compliance activity under Article 23(5) with respect to the Period to which the *comprehensive certainty outcome* relates shall continue to apply. Unless at any point in the future the *coordinating entity* is considered to have withdrawn its request for certainty under Article 30, the *comprehensive certainty outcome* shall continue to apply in all Parties, ensuring a consistent application of the Convention for a Period including for the purpose of the elimination of double taxation.

710. Where a Group would otherwise be required to source revenues using a different *reliable indicator* to that used in its Amount A Tax Return and Common Documentation Package, but the *review panel* or *lead tax administration* accepts that the Group does not have the information necessary to use that *reliable indicator*, the Group shall be allowed to use the *allocation key* applicable to that category of revenues. This ensures that revenues can be sourced using an approach under the Convention even if that is not the preferred approach agreed as part of the *comprehensive certainty review* process. The *comprehensive certainty outcome* shall nevertheless specify the *reliable indicator* that should have been used. While this *comprehensive certainty outcome* does not apply for Periods other than the one to which it relates, in accordance with Annex F, this shall be taken into account by a *review panel* or *lead tax administration* undertaking a *comprehensive certainty review* for a subsequent Period.

Paragraphs 5 through 10

711. Paragraphs 5 through 10 concern the outcomes of a *scope advance certainty review* or *advance certainty review*. Where a *coordinating entity* has submitted a request for *scope advance certainty* or *advance certainty* and this is not withdrawn, the *scope advance certainty review* or *advance certainty review* shall end with an agreed *advance certainty outcome*. This outcome shall either agree the proposed approach included with the *coordinating entity's* request for certainty or specify any changes to this proposed approach which are required. It shall also set out the Periods for which certainty is provided and the *critical assumptions* that must continue to apply. The outcome shall include any improvements that are required to relevant aspects of the Group's *internal control framework*.

712. Under paragraph 5, the *advance certainty outcome* shall cease to apply at the end of the last Period specified in the outcome, or when one or more of the *critical assumptions* included in that outcome ceases to apply. The fact that an *advance certainty outcome* no longer applies does not mean that the approach contained in that outcome is not correct. When the *coordinating entity* submits a request for *scope certainty* under Article 22 or *comprehensive certainty* under Article 23, it may submit a new request for *scope advance certainty* or *advance certainty* with respect to the same proposed approach (or an amended approach) to apply in subsequent Periods.

713. Where a *coordinating entity* has requested *advance certainty* with respect to a Group's proposed revenue sourcing approach, the agreed *advance certainty outcome* requires changes to the proposed approach submitted by the *coordinating entity*, and the *review panel* accepts that the Group does not have access to the necessary information to apply the agreed approach for the first Period covered by *advance certainty*, under paragraph 6 the *advance certainty outcome* may also include a different *reliable method* that may be used by the *coordinating entity* for that Period.

714. Paragraph 6 only permits this different *reliable method* to be used for the first Period covered by the *advance certainty outcome*. For subsequent Periods, a *coordinating entity* should obtain the information required to apply the approach agreed in the *advance certainty outcome*.

715. The first time a Group requests certainty over a particular aspect of the Convention, an *advance certainty outcome* shall be granted for all Periods ending with 36 months of the start of the Period specified in the request for *scope advance certainty* or *advance certainty*. Following subsequent requests, a *scope review panel* or *review panel* may extend this period to 60 months. Where the *advance certainty outcome* concludes that relevant aspects of the Group's *internal control framework* are designed and operating effectively, this outcome shall apply in all of these Periods subject to *critical assumptions* continuing to be met. However, where the *advance certainty outcome* requires specified improvements to be made to the Group's *internal control framework*, the outcome shall only apply once these improvements have been made and this is confirmed as part of a *scope certainty review* or *comprehensive certainty review*.

716. Where one or more *critical assumptions* are no longer met, an *advance certainty outcome* shall cease to apply. Paragraph 10 provides that, where a *coordinating entity* anticipates or becomes aware that one or more *critical assumptions* are no longer met, it should be required to inform the *lead tax administration* that this is the case, and this information shall be exchanged with other *listed parties* (for a *scope advance certainty review*) or *affected parties* (for an *advance certainty review*).

Article 30 – Withdrawal of a request for certainty

Paragraph 1

717. Paragraph 1 includes a number of scenarios where a *coordinating entity* has withdrawn or shall be considered to have withdrawn its request for certainty.

- a) A *coordinating entity* may withdraw its request for certainty at any time by notifying the *lead tax administration*.
- b) Where a *coordinating entity* submitted a request for certainty, but this was not a valid request because it was not in the correct format or does not include all of the required information, the *coordinating entity* shall be informed of this and given time to correct the request in accordance with Article 22(3) or 23(3). Where any errors are not corrected or missing information is not provided by the applicable deadline, the *coordinating entity* shall be considered to have withdrawn its request for certainty.
- c) There is an expectation that a *coordinating entity* that has requested certainty shall provide information in a timely manner and shall act in a cooperative and transparent manner throughout any review process, and that other Group Entities shall ensure that the *coordinating entity* has access to any information that it needs. Where this is not the case, and concerns are not addressed, a *scope review panel*, *review panel* or *lead tax administration* may determine that certainty cannot be provided, and the *coordinating entity* shall be considered to have withdrawn its request for certainty. Annex F includes at Section 1(19) a process to determine whether a *coordinating entity* has been persistently late in providing information without explanation, or has acted in an uncooperative or non-transparent manner, including by providing incomplete or inaccurate information, and that certainty cannot be provided in these circumstances.
- d) Subject to subparagraph (c), where a *coordinating entity* submits a valid request for certainty, it shall receive an agreed *certainty outcome* which may require changes to a Group's Amount A Tax Return and Common Documentation Package (where a *coordinating entity* submitted a request for *comprehensive certainty*) or to a proposed approach contained in a request for

scope advance certainty or *advance certainty*. Where a *coordinating entity* does not agree to the changes required in a *certainty outcome*, it shall be considered to have withdrawn its request for certainty.

- e) Where a *coordinating entity* submitted a request for *comprehensive certainty* over its application of the Convention for a Period, and an agreed *comprehensive certainty outcome* has been granted, there is no reason why a Group Entity would submit a tax return in any Party that is inconsistent with this *comprehensive certainty outcome*. Where a tax return is submitted that is inconsistent with an agreed *comprehensive certainty outcome*, the *coordinating entity* shall be considered to have withdrawn its request for certainty. A *coordinating entity* shall not be considered to have withdrawn its request for certainty if the Group Entity is able to withdraw a tax return that is inconsistent with a *comprehensive certainty outcome*, or to file a further tax return that is consistent with that outcome, and it does so.

Paragraph 2

718. Where a *coordinating entity* gives written notification that it withdraws its request for *scope certainty* or *comprehensive certainty* or is considered to withdraw its request under paragraph 1, the Competent Authority of the Party of the *lead tax administration* shall within 30 days give notice that this has occurred to the Competent Authorities of all Parties.

719. Where a *coordinating entity* gives written notification that it withdraws its request for *scope advance certainty* or *advance certainty* or is considered to withdraw its request under paragraph 1, the Competent Authority of the Party of the *lead tax administration* shall within 30 days give notice that this has occurred to the Competent Authorities of all *listed parties* or all *affected parties*, as applicable.

Paragraph 3

720. Paragraph 3 makes it clear that, where a *coordinating entity* withdraws its request for certainty, a Party may rely upon any work that was conducted by a *scope review panel*, *review panel* or the *lead tax administration*, and its tax administration may undertake its own enquiries with respect to a Group's application of the Convention, as permitted under its Jurisdiction's law and procedures.

721. Paragraph 3 also makes clear that, where a *coordinating entity* withdraws its request for certainty, there is nothing to prevent a Party from allowing a Group Entity to rely on domestic remedies.

722. Finally, paragraph 3 makes clear that a *coordinating entity* may submit a request for *scope certainty* or *comprehensive certainty* for a later Period, even where it has withdrawn a request for certainty for an earlier Period.

Article 31 – Tax examinations where a request for certainty is not made, or is withdrawn or is considered to have been withdrawn

Paragraph 1

723. Paragraph 1 makes clear that, where a Group has not made a request for *scope certainty* or *comprehensive certainty*, or where a request for certainty is withdrawn or considered to be withdrawn then,

subject to Article 30, there is nothing in the Convention to prevent the tax administration of a Party from undertaking a tax examination of the Group within its Jurisdiction as permitted under its Jurisdiction's law and procedures, or in accordance with Article 37 with particular reference to Article 37(9).

724. Where the *coordinating entity* of a Group has withdrawn its request for certainty, or is considered to have withdrawn its request, Article 30(3)(a) provides that there is nothing to prevent a *listed party* or *affected party* from relying on work exchanged with the Competent Authority of that Party by the Competent Authority of the Party of the *lead tax administration*, and this includes for purposes of a domestic tax examination.

Paragraph 2

725. Under paragraph 2, and in accordance with Article 37, two or more Parties may cooperate in undertaking a tax examination of a Group. The Competent Authorities of these Parties shall agree the scope and procedures for undertaking such a tax examination. For example, an examination may be limited to a particular aspect of the Convention, or be with respect to all aspects of rules on Amount A.

Paragraph 3

726. Paragraph 3 establishes that before a Party commences a domestic tax examination to determine whether a Group is a Covered Group for a Period, or before any multilateral tax examination is undertaken under paragraph 2, notice shall be given either to the *coordinating entity* of the Group or to any Group Entity.

727. A process to give notice under paragraph 3 shall be agreed by the Conference of the Parties.

728. Where notice has been given under this paragraph, Article 22(1) and 23(1) provide a period for the *coordinating entity* of a Group to submit a request for *scope certainty* or *comprehensive certainty* as applicable. Where a request for certainty is accepted under one of those Articles, provisions concerning the suspension of domestic compliance activity shall apply.

Article 32 – Definitions

729. Article 32 contains a number of definitions used throughout Part V Section 2, including the following.

Scope certainty, follow-up scope certainty, scope advance certainty, comprehensive certainty, advance certainty

730. Part V Section 2 contains provisions for a Group to be provided with different categories of certainty, depending upon the circumstances and needs of that Group.

- *Scope certainty* concerns whether a Group is a Covered Group for a specific Period specified in the request. This certainty is likely to be of interest to Groups that are outside the scope of the Convention, but wish to remove the risk of tax examinations in different Jurisdictions to determine whether this is the case. *Scope certainty* may be requested under Article 22(1).
- *Follow-up scope certainty* concerns whether a *qualifying extractives group* or Group that includes one or more *regulated financial institutions*, which has previously obtained a *scope certainty outcome* that it is not a Covered Group, continues not to be a Covered Group in a later Period.

This certainty is likely to be of interest to Groups in these categories that meet conditions in Article 22(7). *Follow-up scope certainty* may be requested under Article 22(1).

- *Scope advance certainty* concerns whether *listed parties* agree that a Group's proposed approach to applying aspects of rules applicable to a *qualifying extractives group* or Group that includes one or more *regulated financial institutions* is correct, and whether relevant aspects of the Group's *internal control framework* are designed and operating effectively. This removes the need for these issues to be re-considered for Periods in which an *advance certainty outcome* applies. *Scope advance certainty* may be requested under Article 22(2).
- *Comprehensive certainty* concerns whether the application of the Convention in a Covered Group's Amount A Tax Return and Common Documentation Package for a specified Period is correct or if changes are required. This certainty is likely to be of interest to Covered Groups that wish to remove the risk of tax examinations in different Parties. *Comprehensive certainty* may be requested under Article 23(1).
- *Advance certainty* concerns whether *affected parties* agree that a Group's proposed approach to applying rules on the sourcing of Adjusted Revenues, or aspects of rules applicable to a *qualifying extractives group* or Group that includes one or more *regulated financial institutions* is correct, and whether relevant aspects of the Group's *internal control framework* are designed and operating effectively. This removes the need for these issues to be re-considered for Periods in which an *advance certainty outcome* applies. *Advance certainty* may be requested under Article 23(2).

Scope certainty documentation package, follow-up scope certainty documentation package, advance certainty documentation package

731. The *scope certainty documentation package, follow-up scope certainty documentation package* and *advance certainty documentation package* refer to standardised documentation packages containing information for the purpose of undertaking a *scope certainty review, follow-up scope certainty review, scope advance certainty review* or *advance certainty review*. The use of standardised documentation will facilitate the process for a Group to prepare a request for certainty and will improve the efficiency and consistency of reviews undertaken. The format and content of these documentation packages shall be agreed by the Conference of the Parties.

732. The Amount A Tax Return and Common Documentation Package, containing information for the purpose of undertaking a *comprehensive certainty review* is defined at Article 15.

Scope certainty review, follow-up scope certainty review, scope advance certainty review, comprehensive certainty review, advance certainty review

733. *Scope certainty review, follow-up scope certainty review, scope advance certainty review, comprehensive certainty review* and *advance certainty review* refer to the process for each type of certainty to be provided to a Group. This includes a substantive review by a *scope review panel, review panel* or *lead tax administration*, described in Article 26 and Annex F Section 1. It also includes the resolution of any disagreements by a *determination panel*, described in Article 27 and Annex F Section 2.

Scope certainty outcome, comprehensive certainty outcome, advance certainty outcome

734. Each category of certainty that may be requested under Article 22 or 23 gives rise to a *certainty outcome* for a Group, the content and extent of which are set out in Articles 29 and 30.

- A *scope certainty outcome* is provided at the conclusion of a *scope certainty review* or *follow-up scope certainty review*, and provides certainty as to whether or not *listed parties* agree that a Group is not a Covered Group or that it continues not to be a Covered Group for a Period. A *scope certainty outcome* is binding on all *listed parties*.
- A *comprehensive certainty outcome* is provided at the conclusion of a *comprehensive certainty review*, and provides certainty as to whether *affected parties* agree the application of the Convention in the Group's Amount A Tax Return and Common Documentation Package for a Period, or if changes are required. A *comprehensive certainty outcome* is binding on all Parties.
- An *advance certainty outcome* is provided at the end of a *scope advance certainty review* or *advance certainty review*, and provides certainty as to whether *listed parties* or *affected parties* agree that the approaches contained in the *advance certainty documentation package* are correct and if relevant aspects of the Group's *internal control framework* are designed and operating effectively. An *advance certainty outcome* also includes agreed *critical assumptions* which must be met for the *advance certainty outcome* to continue to apply. An *advance certainty outcome* is binding on all *listed parties* or all *affected parties*, as applicable.

Scope review panel, review panel

735. A *scope review panel* and a *review panel* are panels of tax administrations from *listed parties* or *affected parties* established to undertake a review in circumstances described in Article 24. Where a *scope review panel* or *review panel* is to be established, the constitution of the panel shall be as described in Article 25.

Affected party

736. *Affected parties* with respect to a Covered Group for a Period include the Party whose tax administration is the *lead tax administration*, as well as those in which the Group has nexus in accordance with Article 8 or is a *specified jurisdiction* for purposes of Part IV. This may be established based on information contained in the Group's Amount A Tax Return and Common Documentation Package, on the basis of a notification given by Competent Authority of the Party to the Competent Authority of the Party of the *lead tax administration* that it considers itself to be a Party in which the Group has nexus in accordance with Article 8 accompanied by supporting documentation, or in the course of a *comprehensive certainty review*.

Listed party

737. *Listed parties* with respect to a Group for a Period include the Party whose tax administration is the *lead tax administration*, as well as those identified by the *coordinating entity* of a Group in its request for *scope certainty* or on the basis of a notification given by the Competent Authority of the Party to the Competent Authority of the *lead tax administration* that it considers it should be a *listed party*. *Listed parties* shall not include a Party whose Competent Authority notifies the Competent Authority of the *lead tax administration* that it is not a *listed party* under the process in Article 22(5).

Coordinating entity

738. The *coordinating entity* of a Group is the entity that submits a request for certainty under Article 22 or 23, and then acts as the single point of contact within the Group throughout the relevant certainty process. The Designated Payment Entity of the Group shall be the *coordinating entity* unless the Group has designated another Group Entity to act in this role.

Critical assumption

739. A *critical assumption* for purposes of the *tax certainty framework* refers to any fact (whether or not within control of the Group) related to the Group, a third party, an industry, or business and economic conditions, the continued existence of which is material to the granting of an *advance certainty outcome*, agreed as part of an *advance certainty review* or *scope advance certainty review*. This is a vital element of an *advance certainty outcome*, as the *certainty outcome* shall cease to apply if one or more *critical assumptions* are no longer met. This does not mean that the approach included in the *advance certainty outcome* is no longer correct, but this would need to be confirmed by a further certainty review.

Determination panel

740. A *determination panel* is a panel of seven individuals, including *independent experts* and *government officials*, which is required to resolve disagreements with respect to a certainty review pursuant to a request under Article 22 or 23. The constitution of a *determination panel* is set out in Article 28 and Annex F Section 3.

Lead tax administration

741. The *lead tax administration* plays a central role in the *tax certainty framework*, accepting requests for certainty from the *coordinating entity* of a Group, and then coordinating or undertaking certainty reviews on behalf of other Parties. In the first instance, the *lead tax administration* shall be the tax administration in the Party in which the Designated Payment Entity of a Group is resident. Where the Designated Payment Entity is transparent in the Party where it is organised, it shall be treated for these purposes as resident in that Party.

742. Article 32 also includes specific rules that allow the tax administration in a different Party to be *lead tax administration* in specific circumstances. First, this is only permitted where the different Party is one with which the Group has a significant connection, which is defined as the Party in which the Group had the highest average unrelated party revenue, tangible fixed assets or number of employees located in the Period and the four immediately preceding Periods. A Group also has a significant connection with the Party whose tax administration was most recently the *lead tax administration* of the Group. Second, the tax administration of one of these Parties may only be the *lead tax administration* where this is agreed by the *coordinating entity*, by the tax administration in the Party in which the Designated Payment Entity is resident, and the tax administration in the Party with which the Group has a significant connection. As such, the tax administration in the Party in which the Designated Payment Entity is resident shall always be the *lead tax administration*, unless it agrees otherwise.

743. Article 32 also includes specific rules to identify the *lead tax administration* in cases where the Designated Payment Entity of a Group is resident in a Jurisdiction that does not have a tax administration, or is resident in two Jurisdictions. The Conference of the Parties may agree further circumstances in which another tax administration may be the *lead tax administration* for a Group.

Tax certainty user fee

744. A tax certainty user fee is payable by a coordinating entity to the lead tax administration together with a request for certainty under Article 22 or 23. This fee, which may be different for the different types of certainty that may be requested under those Articles, shall be agreed by the Conference of the Parties.

Section 3 – Tax certainty for issues related to Amount A

Article 33 – Mutual Agreement Procedure – Covered tax agreement

Paragraphs 1 through 3

745. Article 33 is intended to provide a member of a Covered Group access to a mutual agreement procedure concerning *related issues*, separate and distinct from and coexisting with access to the mutual agreement procedure provided under the *covered tax agreement* or other instruments. Article 33 has been designed to ensure access to MAP and the implementation of MAP agreements in all eligible cases, along with the possibility to move to the dispute resolution procedure under Article 35 unless both *MAP competent authorities* consider the case ineligible for the bilateral stage of MAP. Thus, a unilateral determination that access to MAP under a *covered tax agreement* should be denied or that the objection should be considered not justified would generally not prevent access to MAP or the resolution of MAP cases under Article 33 where the other *MAP competent authority* considers the case to be justified.

746. Article 33 provides that a member of a Covered Group may make a request for a mutual agreement procedure to the *MAP competent authorities* of both *covered jurisdictions* where that member of a Covered Group considers that the actions of one or both of the *covered jurisdictions* result or will result for that member of a Covered Group in taxation connected with a *related issue* not in accordance with the provisions of that *covered tax agreement*. Such a request must be presented with a written statement that the member of a Covered Group considers that the case involves taxation connected with a *related issue*. The case must be presented within three years from the first notification of the action resulting in taxation connected with a *related issue* not in accordance with the provisions of the *covered tax agreement*.

747. The presentation of a case to both *MAP competent authorities* pursuant to paragraph 1 is intended to reinforce the general principle that access to the mutual agreement procedure for taxation connected with *related issues* should be as widely available as possible. Article 33 does so by providing Covered Groups with the possibility to ensure that decisions as to whether a case should proceed to the second stage of the mutual agreement procedure (i.e., be discussed by the *MAP competent authorities* of both *covered jurisdictions*) are open to consideration by both *MAP competent authorities*. Article 33 functions as a backstop to the MAP provisions of *covered tax agreements*, helping to ensure that both *MAP competent authorities* are made aware of MAP requests and have the opportunity to provide their views on whether a MAP request should be accepted or rejected and on whether the taxpayer's objection is considered to be justified.

748. The general principle underlying Article 33 is best served where the member of the Covered Group presents its MAP request to both *MAP competent authorities* at approximately the same time, recognising that there may be practical or other difficulties with a simultaneous presentation of a MAP request to both *MAP competent authorities*. Although paragraph 1 does not provide a time period within which the MAP request must be submitted to the second *MAP competent authority* following submission to the first *MAP competent authority*, the member of a Covered Group should submit both requests as close in time as possible.

749. In some circumstances, different members of the Covered Group affected by the same transfer pricing adjustment may wish to submit separate MAP requests with respect to the same adjustment to the *MAP competent authorities* of their respective jurisdictions of residence. In such cases, each MAP request need not be submitted to both *MAP competent authorities* under paragraph 1 as both *MAP competent authorities* are deemed to have received both MAP requests. However, both *MAP competent authorities* should be made aware of the MAP requests at an early stage even though the same member of the Covered Group did not submit them. Each member of a Covered Group affected by an adjustment should

coordinate with the other relevant members of a Covered Group before the filing of any MAP requests, including regarding the choice to present a MAP request pursuant to Article 33 or the MAP provisions of a *covered tax agreement*. Where a MAP request with respect to the same *related issue* is presented by one member of a Covered Group under Article 33 and by another Entity of a Covered Group under the MAP provisions of a *covered tax agreement*, the *MAP competent authorities* will have to consult with the members of the Covered Group to determine under which instrument the case should be considered submitted. Coordination by the members of a Covered Group can avoid duplicative MAP requests and promote a more effective and efficient MAP from the perspectives of both the Covered Group and the *MAP competent authorities*. In any case, a MAP request should indicate whether a MAP request with respect to the same *related issue* was submitted to the *MAP competent authority* of the other *covered jurisdiction*. For purposes of Article 35, this information is expressly included as part of the “information necessary to undertake substantive consideration of the case” (see Article 35(4)).

750. Where both *MAP competent authorities* have received a MAP request, the case should proceed to the bilateral stage of the mutual agreement procedure (potentially allowing access to the dispute resolution panel procedure) if either *MAP competent authority* accepts the case in MAP and considers that the objection raised in the request is justified. Therefore, in general, a unilateral determination that access to MAP should be denied or that the objection should be considered not justified in a case under Article 33 would not prevent a case from proceeding to the bilateral stage. However, as set out in the Commentary on the OECD Model (see for example paragraph 10 of the Commentary to Article 9), some *covered tax agreements* limit the length of time during which a primary adjustment may be made to increase the profits of an enterprise (for example, under Article 9(1) or Article 7(2) of the OECD Model). The objective of such time limits is to prevent double taxation in situations where no corresponding adjustment would be available following the primary adjustment. Where such an adjustment is made after the time limit specified in the *covered tax agreement* and a MAP request is filed challenging the adjustment, the *MAP competent authority* of the adjusting jurisdiction should unilaterally reverse the adjustment, as this would be an action resulting in taxation not in accordance with the *covered tax agreement*, without proceeding to the bilateral stage of MAP under Article 33(2). Where the other *MAP competent authority* can establish that the adjustment in the other jurisdiction was made after the time limits for adjustments specified in the *covered tax agreement*, the case need not proceed to the bilateral stage of the mutual agreement procedure as both *MAP competent authorities* would receive MAP requests under Article 33 and the *MAP competent authority* of the adjusting jurisdiction should provide unilateral relief.

751. In circumstances where a member of a Covered Group presents its case to the *MAP competent authorities* of both *covered jurisdictions* pursuant to Article 33, *MAP competent authorities* may follow their established case-handling practices and their published MAP programme guidance, including on aspects of filing MAP requests and their processing. These case-handling practices and MAP programme guidance would be subject to the different milestones and deadlines provided in Article 35 with respect to determining the “start date” of the MAP case. Depending on its practice, the *MAP competent authority* of the *covered jurisdiction* of residence of the taxpayer that made the MAP request, or of the *covered jurisdiction* that made the adjustment at issue in the MAP case, would generally take the lead in the unilateral phase of the MAP case. Although the procedures used in the context of a particular MAP case or bilateral relationship will vary, the *MAP competent authority* of the *covered jurisdiction* that took the action that led to the taxation which is alleged to be contrary to the *covered tax agreement* would then in the bilateral phase of the MAP case routinely provide a position paper to the other *MAP competent authority* to explain the basis for the adjustment. In all cases, the *MAP competent authorities* are encouraged to communicate at the beginning of the MAP process to facilitate a coordinated approach to the case and a shared understanding of the steps each will take in the process of endeavouring to agree on a resolution.

752. A member of a Covered Group that presents its case pursuant to Article 33 must also provide a written statement that the case may involve taxation connected with a *related issue*. The term “related

issue” is defined for purposes of Part V Section 3 in Article 34(1). This written statement is intended to inform *MAP competent authorities* at the beginning of the MAP case that unresolved *related issues* arising from the MAP case could potentially be submitted to a dispute resolution panel.

753. Paragraph 2 of Article 33 includes the second sentence of Article 25(2) of the OECD and UN Models to ensure that resolutions of MAP cases that are agreed by the *MAP competent authorities* are implemented notwithstanding domestic law time limits. This language addresses obstacles to the implementation of *MAP competent authority* mutual agreements that may arise in practice where a MAP article does not include the second sentence of Article 25(2). A member of a Covered Group would have no access to the dispute resolution panel mechanism where a *MAP competent authority* mutual agreement had resolved *related issues* but was not implemented, even though the *related issues* would in substance remain unresolved in such cases.

754. The remaining language of Article 33(1) through (3) is based on the language of Article 25(1), (2) and (4) of the OECD and the UN Model.

755. For the avoidance of doubt, where both *MAP competent authorities* agree, they may, where appropriate, extend the outcome of a MAP case to cover subsequent Periods, in particular where the facts and circumstances of the relevant transactions or activities remain unchanged. This may facilitate the resolution of recurring issues that could otherwise give rise to multiple, duplicative MAP cases. Depending on the *MAP competent authorities'* MAP practices and procedures, a MAP outcome could potentially be extended by mutual agreement to subsequent Periods for which the member of a Covered Group has filed tax returns (but with respect to which it has not filed MAP requests) or reflected in a bilateral advance pricing arrangement for future years. Any decision to extend a MAP outcome to subsequent Periods would in all cases remain subject to the discretion of the *MAP competent authorities*, based on the facts and circumstances of those subsequent Periods.

756. It is acknowledged that Part V Section 3, including Article 33 deal with bilateral MAP cases arising from *covered tax agreements*. However, it is also acknowledged that several *covered jurisdictions* are already able to combine multiple MAP cases filed under *covered tax agreements* to deal with them multilaterally. Depending on the requirements of the *covered jurisdictions* involved, such cases are either started through one MAP request under the equivalent of Article 25(1) of the OECD Model or the UN Model filed by the taxpayer under one *covered tax agreement*, and the *MAP competent authorities* coordinate with additional *covered jurisdictions* using the equivalent of Article 25(3) of the OECD Model or the UN Model contained in the other *covered tax agreements* for a multilateral solution; or through multiple MAP requests under the equivalent of Article 25(1) of the OECD Model or the UN Model filed by the taxpayer for each individual *covered tax agreement*. Irrespective of the approach used, if the request(s) are eligible for MAP and proceed to the discussion stage, the discussion stage of MAP could essentially be multilateral: competent authorities would either have multilateral discussions or coordinated multiple bilateral discussions. The aim would be to have a single multilateral agreement or coordinated bilateral agreements that would ensure that taxation not in accordance with all the treaties concerned is removed. *MAP competent authorities* of *covered jurisdictions* that are interested to consider MAP cases under Article 33 multilaterally may refer to the Manual on the Handling of Multilateral Mutual Agreement Procedures and Advance Pricing Arrangements (“MoMA”) released by the OECD Forum on Tax Administration for further guidance on the legal and procedure aspects to consider, subject to domestic law constraints and legal requirements of the *covered jurisdictions* concerned.

Paragraph 4

757. Paragraph 4 allows *MAP competent authorities* of the *covered jurisdictions* to resolve difficulties or doubts as to the interpretation or application of issues arising from that *covered tax agreement* that are

covered under the definition of “related issue” under Article 34(1) (i.e. the equivalent of Article 5, 7 or 9 of the OECD Model or the UN Model). While the equivalent of Article 25(3) of the OECD Model or the UN Model contained in *covered tax agreements* should already allow this, paragraph 4 would extend the possibility to do this even where the concerned *covered tax agreement* does not contain that equivalent provision. Since that paragraph in *covered tax agreements* can allow *MAP competent authorities* to enter into bilateral or multilateral advance pricing arrangements, as recognised in paragraph 52 of the Commentary on Article 25 of the OECD Model and paragraph 10 of the Commentary on Article 25 of the UN Model, paragraph 4 can allow *MAP competent authorities* to enter into such arrangements with respect to provisions of a *covered tax agreement* concerning *related issues* even where the *covered tax agreement* does not contain the equivalent of Article 25(3) of the OECD or the UN Model.

Paragraph 5

758. Paragraph 5 addresses the interactions of Article 33 with the mutual agreement procedure provisions of *covered tax agreements*, Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union (the “EU tax dispute resolution Directive”) or in the Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (90/436/EEC) (the “EU Arbitration Convention”). In particular, these provisions reflect the circumstance that the EU tax dispute resolution Directive already includes a requirement to submit a complaint simultaneously to each of the *MAP competent authorities* involved (see Article 3(1) of the EU tax dispute resolution Directive). The EU Arbitration Convention similarly requires an enterprise to notify the *MAP competent authorities* of the other Contracting States concerned by a case at the same time as it presents its case to the *MAP competent authority* of its Contracting State of residence (or to the *MAP competent authority* of the Contracting State in which its permanent establishment is situated). These provisions also reflect the situation that the EU tax dispute resolution Directive, the EU Arbitration Convention and some *covered tax agreements* already provide for a mandatory binding dispute resolution mechanism, such as an arbitration panel or similar body, which is required to be set up, upon the request of the member of the Covered Group or automatically, after a set time period to resolve unresolved issues arising from a mutual agreement procedure case.

759. Paragraph 5 creates a framework whereby Article 33 is not available to a member of a Covered Group where the *covered tax agreement* contains a mandatory binding dispute resolution mechanism for unresolved MAP cases or where the EU tax dispute resolution Directive or the EU Arbitration Convention (which allow for such a mechanism as well) applies, unless the *covered jurisdictions* concerned agree in general that Article 33 should be applicable as well for a particular bilateral relationship. This means that where existing provisions in *covered tax agreements* containing a mandatory binding dispute resolution mechanism for unresolved MAP cases apply or the EU tax dispute resolution Directive or the EU Arbitration Convention applies, Article 33 would generally not be applicable, even if these existing provisions allow for specific types of cases to be excluded from the scope of the mandatory binding dispute resolution mechanism contained therein. Given the definition of the term “covered tax agreement” in Article 34(6)(b), all references in paragraph 5 to a “covered tax agreement” refer to provisions of such agreement as they may have been modified or amended by any subsequent protocol or another agreement, or as their application may have been modified by the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS Multilateral Instrument), regardless of whether agreements have been entered into between *MAP competent authorities* concerning the mode of application of these provisions. Where the *covered jurisdictions* enter into an agreement to make Article 33 applicable to *covered tax agreements* or other instruments containing MAP provisions that already provide for mandatory binding dispute resolution as noted above as well or where the *covered tax agreement* does not contain a mandatory binding dispute resolution mechanism, it is clarified that the taxpayer has the choice to submit a MAP request under Article 33 or under the mutual agreement procedure article of the *covered tax agreement*, the EU tax dispute resolution Directive or the EU Arbitration

Convention (“other available MAP provisions”). Paragraph 5 goes on to define rules for the interaction between Article 33 and other available MAP provisions in situations where both may co-exist.

760. Paragraph 5(a) addresses the interactions of paragraphs 1 and 2 with the MAP provisions of *covered tax agreements* or other instruments that provide for the resolution of unresolved MAP disputes by a mandatory binding dispute resolution mechanism. Paragraph 5(a) provides that, except to the extent that the *covered jurisdictions* agree otherwise, the provisions of paragraphs 1 and 2 shall not apply with respect to the presentation of a mutual agreement procedure case concerning taxation connected with a *related issue* and not in accordance with the provisions of a *covered tax agreement* where that *covered tax agreement* provides that a mandatory binding dispute resolution mechanism, such as an arbitration panel or similar body, is required to be set up, upon the request of the member of the Covered Group or automatically, after a set time period to resolve unresolved issues arising from a mutual agreement procedure case or where the presentation of the case is also possible under the EU tax dispute resolution Directive or the EU Arbitration Convention. Since Part V Section 3 is intended to ensure an efficient, effective and timely mutual agreement procedure that includes a mandatory binding dispute resolution mechanism to resolve unresolved cases and such other available MAP provisions include the same, paragraphs 1 and 2 are not made applicable to situations that may be covered by these provisions. However, *covered jurisdictions* may always agree to apply Article 33 in these situations as well. It is also envisaged in this paragraph that provisions that allow an automatic initiation of a mandatory binding dispute resolution mechanism to resolve unresolved cases after a certain time period would also be covered. In other words, where a *covered tax agreement* or other such instrument includes mandatory binding dispute resolution, Article 33 will not apply, unless the *covered jurisdictions* agree otherwise. *covered jurisdictions* would thus, have discretion as to whether they would like to enter into an agreement that Article 33 should apply in these cases and where they do, as to the form and contents of the same. Where such an agreement is entered into, it would derive its legal basis from paragraph 5(a) itself.

761. Paragraph 5(b) provides that Article 33(1) through (3) apply at the option of a member of a Covered Group subject to paragraph 5(a). This means that in these cases, a member of a Covered Group will have the option to present its MAP case pursuant to Article 33(1) or pursuant to the other available MAP provisions, where these options are available. Paragraph 5(b) also provides that where a member of a Covered Group has not opted to present a MAP case pursuant to Article 33(1), but has presented a mutual agreement procedure case pursuant to other available MAP provisions, the provisions of paragraphs 1 through 3 shall not affect the application of such provisions.

762. Paragraph 5(c) clarifies the interaction of Article 33 with other available MAP provisions in a situation where a first MAP request was filed under another available MAP provision and a second MAP request is sought to be filed under Article 33, subject to paragraph 5(a). In such circumstances, a Covered Group would not be allowed to file a second MAP request under Article 33 concerning that specific issue for the same year. This would ensure that a Covered Group does not seek to initiate a new MAP case under Article 33 while an existing MAP case is ongoing. However, where a Covered Group’s MAP request under another available MAP provision has been submitted to only one *MAP competent authority* and has already been rejected unilaterally, the Covered Group may file a MAP request under Article 33 subject to the conditions under paragraph 1 being fulfilled. This allows the Covered Group the opportunity to file a MAP request under Article 33 where possible to allow the other *MAP competent authority* to consider the merits of the MAP case even where one *MAP competent authority* has rejected the MAP request.

763. Paragraph 5(d) clarifies the interaction of Article 33 with other available MAP provisions in a situation where a first MAP request was filed under Article 33 and a second MAP request is sought to be filed under an other available MAP provision, except the EU tax dispute resolution Directive (which is separately discussed under paragraph 5(e)), subject to paragraph 5(a). In such circumstances, consideration of the first MAP request filed under Article 33 would be suspended and the dispute resolution

procedure under Article 35 would no longer apply to that first MAP request in any circumstance. The receiving competent authority(/authorities) would consider and move ahead with the second MAP request and the dispute resolution procedure under Article 35 would still apply to this second MAP request. Where a MAP request filed under Article 33 has already been rejected by both *MAP competent authorities* involved without proceeding to the bilateral stage of MAP, a second MAP request under an other available MAP provision covered under paragraph 5(d) would usually be similarly rejected. However, it is clarified that where a MAP request under Article 33 is only rejected owing to the fact that the issue concerned is not a “related issue”, the consideration of the second MAP request under the concerned other available MAP provision would not be affected. In such circumstances, *MAP competent authorities* should ensure that the second case is considered based on its merits under the other available MAP provision.

764. Where a MAP request comprises a mix of *related issues* as well as issues that are not *related issues* under other available MAP provisions, the rules specified in paragraph 5(c) and (d) would generally give priority to that MAP request over a request under Article 33. However, *MAP competent authorities* shall allow taxpayers to withdraw *related issues* from consideration under other available MAP provisions under paragraph 5(c) to allow a fresh MAP request to be filed under Article 33 for these issues, while the MAP request initially filed under other available MAP provisions can continue for issues that are not *related issues*.

765. Where a *related issue* is the subject of adjustments or assessments for multiple Periods that the member of the Covered Group wishes to challenge through MAP, the concerned member of the Covered Group should ordinarily follow the same legal basis for MAP i.e., either Article 33 or other available MAP provisions with respect to all Periods to avoid different procedures being applicable to MAP cases concerning the same issue. Although the choice of remedy with respect to each Period is left to the member of the Covered Group, subject to paragraph 5(a), *MAP competent authorities* may only be able to consider the possibility of a multi-year resolution of recurring issues in MAP as noted in paragraph 755 above where the same legal basis is followed for MAP for each relevant Period.

766. Paragraph 5(e) provides that subject to paragraph 5(a), the submission of a complaint as provided under the EU tax dispute resolution Directive (or any of its amending or succeeding instruments or acts of European Union law) shall put an end to any ongoing mutual agreement procedure with respect to the same case that was initiated pursuant to paragraph 1. This would be a consequence of Article 16(5) of the EU tax dispute resolution Directive in any case, but paragraph 5(e) serves to confirm this result.

767. Provisions of a mutual agreement procedure article based on or equivalent to Article 25(5) of the OECD Model or Article 25(5) (Alternative B) of the UN Model would not apply with respect to a mutual agreement procedure case presented pursuant to Article 33. This is because these MAP arbitration provisions apply with respect to MAP cases presented pursuant to the MAP article of the relevant *covered tax agreement*. For MAP cases presented pursuant to the MAP article of a *covered tax agreement* (rather than Article 33), Article 35(14) and (15) address the relationship between the dispute resolution panel mechanism and other mechanisms provided in the MAP article of that *covered tax agreement* for the mandatory and binding resolution of unresolved issues arising from a MAP case.

Article 34 – Definitions

Paragraphs 1 through 5

768. Paragraphs 1 through 5 define the scope of application of the mutual agreement procedure under Article 33 and the dispute resolution mechanism provided for in Article 35 through the definition of “related issue”.

769. Paragraph 1 makes it clear that the mutual agreement procedure under Article 33 and the dispute resolution panel mechanism under Article 35 apply only to issues involving a member of a “Covered Group” (i.e., a Group whose profit may be subject to a tax charge under the new Amount A taxing right). An Entity would be considered a “member of a Covered Group” for this purpose where, for the Period including the date of the adjustment or assessment that is the subject of a request for mutual agreement procedure made under Article 33 or covered by the dispute resolution panel process under Article 35, that Entity is part of a Covered Group or is subject to an adjustment that is specifically included in the definition of *related issue* under this Article, irrespective of whether the Group to which that Entity belongs is a Covered Group for the Period during which the request for mutual agreement procedure or the dispute resolution panel process is submitted. In addition, the term “Covered Group” would follow the definition contained in Article 3. However, as provided in Annex C Section 4, references to “Covered Group” are replaced by references to a “covered segment”, when applying the Convention with respect to a *disclosed segment* of a Group. As a consequence, the dispute resolution panel mechanism will apply also to MAP disputes involving a *segment entity* of a “covered segment”, which by definition will not be a member of a Covered Group. Such a result is appropriate because the resolution of transfer pricing and profit attribution disputes involving a *segment entity* of a *covered segment* will have an impact on the application of Amount A to the *covered segment* just as they would in the case of a dispute involving an Entity of a Covered Group. Finally, since the definition of “related issue” is inherently connected to issues that are included in a *covered tax agreement* between two *covered jurisdictions*, the definition would apply only to transactions that concern members of a Covered Group that are residents of one or both of the *covered jurisdictions* for purposes of that *covered tax agreement*.

770. The definition of “related issue” in paragraph 1 is intended to capture situations where two cumulative conditions are met by the adjustment asserted or the assessment raised by a *covered jurisdiction*

- where they result in either an impact on the elimination of double taxation by *covered jurisdictions* or a “material impact” on the Elimination Profit (or Loss) or Amount A Profit for the *covered jurisdiction*, owing to the assessment or adjustment; and
- where they are covered under provisions in the *covered tax agreement* based on or equivalent to Articles 5, 7 or 9 of the OECD Model or the UN Model, dealing with transfer pricing cases or attribution of profits to permanent establishments, including questions concerning the applicability of these provisions to a case (e.g. questions such as whether a permanent establishment exists or not).

771. It is clarified that all questions concerning the interpretation or application of provisions in the *covered tax agreement* based on or equivalent to Articles 5, 7 or 9 of the OECD Model or the UN Model that are covered in a MAP request under Article 33 or other available MAP provisions would be included in the definition of “related issue”. In addition, questions concerning the applicability of provisions in the *covered tax agreement* based on or equivalent to Articles 5, 7 or 9 of the OECD Model or the UN Model

are included in the definition of “related issues” as well. In this regard, Article 35(1)(b) also provides that the dispute resolution panel shall also resolve any disagreement between *covered jurisdictions* regarding whether an issue is a *related issue*. Accordingly, a disagreement as to whether a particular case is covered by provisions in the *covered tax agreement* based on or equivalent to Articles 5, 7 or 9 of the OECD Model or the UN Model would be decided by the dispute resolution panel. For instance, where one *covered jurisdiction* is of the view that a transaction is a transaction between associated enterprises governed by the provision in the *covered tax agreement* based on or equivalent to Article 9 of the OECD or the UN Model, and the other *covered jurisdiction* is of the view that there is no transaction between associated enterprises covered by that provision and that the payment should be viewed as a distribution to which that provision does not apply, the question as to whether the provision in the *covered tax agreement* based on or equivalent to Article 9 of the OECD or the UN Model is applicable would be a “related issue”. It may also be the case that one *covered jurisdiction* asserts a transfer pricing adjustment in substance, but uses its domestic general anti-avoidance rules to achieve this end, and takes the view that the provision in the *covered tax agreement* based on or equivalent to Article 9 of the OECD or the UN Model does not apply, whereas the other *covered jurisdiction* is of the view that this provision is applicable and in this case as well, the question as to whether that provision is applicable would be a “related issue” (however, see paragraph 782 in this regard as well).

772. While all questions concerning the applicability of provisions in the *covered tax agreement* based on or equivalent to Article 5, 7 or 9 of the OECD Model or the UN Model are covered in the definition of “related issue”, issues may arise concerning whether these provisions or other provisions in a *covered tax agreement* are applicable. This is generally not the case where the applicability of the provision in the *covered tax agreement* based on or equivalent to Article 9 is at issue since questions of pricing of related party transactions would most often fall under that provision in *covered tax agreements*. However, there may be questions concerning whether an adjustment or assessment should be covered as a business profits case (involving provisions in the *covered tax agreement* based on or equivalent to Articles 5 and 7 of the OECD Model or the UN Model) or a case involving other provisions (for e.g. provisions in the *covered tax agreement* based on or equivalent to Article 10, 11 or 12 of the OECD Model or the UN Model). Accordingly, it is also clarified that the Article 5 and 7 cases referred to in paragraph 1 also encompass situations where the *covered jurisdiction* asserting the adjustment or raising the assessment considers it covered under other provisions of a *covered tax agreement*, whereas the Covered Group is of the opinion that the adjustment or assessment should be covered under provisions in the *covered tax agreement* based on or equivalent to Articles 5 and 7 of the OECD Model or the UN Model, under the condition that the position of the Covered Group is shared by the *MAP competent authority* of the other *covered jurisdiction* (“Article 7 characterisation cases”). Accordingly, “Article 7 characterisation cases”, covering questions as to whether a particular assessment or adjustment would be covered by the provision in the *covered tax agreement* based on or equivalent to Article 7 of the OECD Model or the UN Model as opposed to any other provision of a *covered tax agreement*, would be included in the definition of “related issue”. For example, a *covered jurisdiction* may raise an assessment stating that additional income should be taxed as “royalties”, intending for this to be covered under the provision in the *covered tax agreement* based on or equivalent to Article 12 of the OECD Model or the UN Model. However, the member of the Covered Group concerned by the assessment may believe that the assessment raised does not satisfy the definition of the “royalties” provision and take the view that it should be covered under the provision in the *covered tax agreement* based on or equivalent to Article 7 of the OECD Model or the UN Model dealing with “business profits”. On that basis, the member of the Covered Group may take the view that there should be no taxation in that *covered jurisdiction* under the “business profits” provision owing to there being no permanent establishment in that *covered jurisdiction* under the provision in the *covered tax agreement* based on or equivalent to Article 5 of the OECD Model or the UN Model based on the facts of the case. In this situation, the member of the Covered Group may file a MAP request on the basis that the assessment raised results in taxation that is not in accordance with the *covered tax agreement*. Such a MAP case would be covered under the definition of “related issue” to the extent that the *MAP competent authority* of

the other *covered jurisdiction* agrees with the position taken by the member of the Covered Group in the MAP request.

773. Nevertheless, this would also mean that all other cases concerning the application of provisions in the *covered tax agreement* apart from provisions based on or equivalent to Articles 5, 7 or 9 of the OECD Model or the UN Model would not be covered in the definition of “Article 7 characterisation cases”. This includes specifically:

- questions on whether tax has been deducted at source at a rate that is in accordance with the *covered tax agreement*;
- questions concerning a determination as to which among two provisions of a *covered tax agreement* other than those corresponding to Article 7 of the OECD Model or the UN Model would apply;
- questions concerning the application of the beneficial ownership conditions under provisions of the *covered tax agreement* based on or equivalent to Article 10, 11 or 12 of the OECD Model or the UN Model; and
- the application of anti-avoidance rules that are not covered under provisions of a *covered tax agreement* based on or equivalent to Articles 5, 7 or 9 of the OECD Model or the UN Model, which, as noted above, includes questions concerning the applicability of these provisions to a case and “Article 7 characterisation cases”.

774. In “Article 7 characterisation cases”, it is acknowledged that the member of the Covered Group concerned would usually take the position that an assessment is only covered by provisions in the *covered tax agreement* based on or equivalent to Articles 5 and 7 of the OECD Model or the UN Model in its MAP request, even where the assessment being covered under other provisions of the *covered tax agreement* is plausible. Therefore, the *MAP competent authority* of the other *covered jurisdiction* is required to share the position taken by the member of the Covered Group for these cases to be covered. The *MAP competent authority* of the other *covered jurisdiction* should arrive at this determination only after it considers the position taken by the member of the Covered Group justified following discussions between both *MAP competent authorities* and after following procedures regularly undertaken by the *MAP competent authorities* to determine whether cases should be considered under provisions in the *covered tax agreement* based on or equivalent to Articles 5 and 7 of the OECD Model or the UN Model.

775. It is also clarified that since the definition of “related issue” for the purpose of MAP under Article 33 and the dispute resolution procedure under Article 35 is restricted to issues that arise from the application of a *covered tax agreement*, profit allocation adjustments that are not subject to a *covered tax agreement* are not covered by Part V Section 3.

776. Paragraph 2 further defines situations where the adjustment asserted or assessment raised by a *covered jurisdiction* is considered to have an impact on the elimination of double taxation for the purposes of the definition of “related issue”. Paragraph 2 covers situations where such an adjustment or assessment would result in a change in the *covered jurisdictions* required to provide Relief for Amount A taxation for that Covered Group or a change in the Tier(s) for the Allocation of the obligation to eliminate double taxation with respect to Amount A Profit of a *covered jurisdiction* for that Covered Group under Article 11(6) through (15) as the outcome if, based on a deeming approach, the adjustments or assessments were to be included in full in the Elimination Profit (or Loss) of that Covered Group for that *covered jurisdiction* for the Period during which the adjustment or assessment is asserted or raised, irrespective of how such adjustment or assessment is recorded in the Elimination Profit (or Loss) in actual terms. This means that

irrespective of the actual recording of the adjustment or assessment in the Elimination Profit (or Loss) (including a possible spreading of an adjustment or difference in treatment based on the tax amount paid), for the purposes of the test under paragraph 2, the outcomes that would arise under the elimination of double taxation system for Amount A if the adjustment or assessment were to be included in full in the Elimination Profit (or Loss) of that Covered Group for that *covered jurisdiction* for the Period in question need to be measured. If the outcome of applying this deemed test would be a change in the *covered jurisdictions* required to provide for Relief for Amount A or a change in the Tier(s) for the Allocation of the obligation to eliminate double taxation with respect to Amount A Profit of a *covered jurisdiction*, the test under paragraph 2 would be considered met. For instance, if an adjustment of EUR 10 million is asserted by jurisdiction X with respect to a member of a Covered Group in Period Y concerning a single previous fiscal year, the rules for Elimination Profit (or Loss) in Annex B Section 4(7) require the spreading of that adjustment for three total periods and only EUR 3.3 million would be reflected in the Elimination Profit (or Loss) for Period Y. However, for purposes of paragraph 2, the EUR 10 million adjustment would be deemed to be included in full in the Elimination Profit (or Loss) with respect to jurisdiction X and a calculation would be made to verify whether this inclusion would result in a change in the *covered jurisdictions* required to provide Relief for Amount A taxation for that Covered Group or a change in the Tier(s) for the Allocation of the obligation to eliminate double taxation with respect to Amount A Profit of a *covered jurisdiction* for that Covered Group under Article 11(6) through (15) and if so, the test in paragraph 2 is considered met. Reference can be drawn to paragraphs 6 to 15 of Article 11 and paragraphs 386 through 427 of the Explanatory Statement on the specific rules applicable for the elimination of double taxation. For purposes of paragraph 2, there would be a change in the Tier(s) for the Allocation of the obligation to eliminate double taxation with respect to Amount A Profit of a *covered jurisdiction* if owing to the adjustment or assessment if included in full in the Elimination Profit (or Loss) of that Covered Group for that *covered jurisdiction* for the Period during which the adjustment or assessment is asserted, a *covered jurisdiction* moves from one Tier to another for the elimination of double taxation or is allocated the obligation to eliminate double taxation in additional or fewer Tiers as compared to the situation prior to the adjustment or assessment.

777. Paragraph 3 defines situations where the adjustments or assessments are considered to have a material impact on the Elimination Profit (or Loss) or Amount A Profit of the *covered jurisdiction* asserting those adjustments or raising those assessments. This test is based on a materiality threshold measured using the aggregate quantum of all adjustments asserted or assessments raised by a *covered jurisdiction* with respect to members of a Covered Group in a Period, as reflected in the first notifications for such adjustments or assessment by that *covered jurisdiction* and is triggered where the aggregate quantum is greater than EUR 3 million with respect to the first three Periods that follow the entry into force of the MLC and EUR 1.5 million with respect to subsequent Periods. For purposes of paragraph 3, an adjustment asserted or assessment raised includes actions that are covered under provisions in the *covered tax agreement* based on or equivalent to Articles 5, 7 or 9 of the OECD Model or the UN Model, dealing with transfer pricing cases or attribution of profits to permanent establishments, including questions concerning the applicability of these provisions to a case and “Article 7 characterisation cases” as defined above in paragraphs 772 through 774.

778. The aggregate quantum of all the adjustments or assessments for a Period asserted or raised on the entities in a Covered Group by the *covered jurisdiction* making those adjustments or assessments is considered under paragraph 3 to ensure that the definition of “related issue” is only applicable where the Covered Group is subject to a substantial tax exposure in that *covered jurisdiction*. The quantum of each adjustment or assessment would be verified using the first notification of the adjustment or assessment through a final assessment order, notice or other such document that leads to a liability of tax in that *covered jurisdiction*. Where the tax is levied by deduction at the source and is covered under paragraph 1 as an “Article 7 characterisation case”, the quantum of the adjustment or assessment in that case would be the gross amount of the payment that is subject to withholding tax (as opposed to the amount of income

tax withheld). Paragraph 3 is intended to focus solely on the quantum of the adjustment or the assessment to the tax base of the member of the Covered Group and is independent of the ultimate tax liability arising from such an adjustment or assessment and shall thus, not regard the impact of tax attributes that may reduce or eliminate the tax liability on these adjustments, such as net operating losses or other consequences, such as a corresponding (and downward) impact to the member's taxable income under other tax provisions. In addition, paragraph 3 envisages the aggregation of each adjustment asserted and assessment raised by the adjusting *covered jurisdiction* with respect to any member of a Covered Group during the Period, including adjustments with respect to the same transaction covering multiple Periods, even where the quantum of each individual adjustment or assessment is lesser than the threshold amount provided. Where the adjusting *covered jurisdiction* does not use EUR as its functional currency, the threshold is applied by reference to the equivalent amount in the functional currency followed by that *covered jurisdictions* in its adjustments or assessments, as on the date of the first notification for such adjustments or assessments.

779. The Period during which an adjustment is asserted or assessment is raised under paragraphs 2 and 3 shall be determined on the basis of the general definition of Period applicable to a Covered Group under the Convention i.e. a reporting period with respect to which the Ultimate Parent Entity of a Group prepares, or is required to prepare, Consolidated Financial Statements. Accordingly, an issue would be considered a "related issue" only where the adjustment is asserted or the assessment is raised in a Period during which the Group is a Covered Group, irrespective of whether the Group becomes a Covered Group in future years.

780. In contrast to paragraph 3, paragraph 2 does not contain a materiality threshold. Accordingly, an adjustment that does not exceed the threshold in paragraph 3, will meet the definition of a "related issue" under paragraph 2 if the adjustment or assessment, if treated as included in full in the Elimination Profit (or Loss) of the *covered jurisdiction* for the Period, results in the consequences described therein.

781. Paragraph 4 contains additional provisions connected to the application of Article 34 and in particular, paragraphs 1 through 3. Paragraph 4(a) contains a backstop rule that ensures that a recurring issue that was unresolved in MAP for a member of a Covered Group with respect to a previous Period for a period of more than two years should not be subject to the materiality condition in paragraph 3 in the current year and onwards. In such situations, the same issue concerning the same member of a Covered Group for future Periods would always be considered a "related issue", notwithstanding whether the materiality threshold under paragraph 3 is met or not. The two-year period under this paragraph should be calculated using the same rules as provided under Article 35(3) through (7). However, it is clarified that this backstop rule does not extend to similar issues for the same member of a Covered Group or for the same issue concerning any other taxpayer. In addition, paragraph 4(b) provides that an adjustment or assessment that is considered by a *covered jurisdiction* to be asserted or raised under the provisions of a *covered tax agreement* based on or equivalent to Articles 10, 11 and 12 of the OECD Model or the UN Model or Article 12A of the UN Model, but that involves questions concerning the applicability of provisions of a *covered tax agreement* based on or equivalent to Article 5, 7 or 9 of the OECD Model or the UN Model covered under paragraph 1, included in the references to "Article 7 characterisation cases" in paragraphs 772 through 774 above, would only be included for the purposes of the determination in paragraph 3 to the extent that the assessment or adjustment is considered to have an impact on Amount A owing to a Withholding Tax Upward Adjustment under Annex B Section 6 or a *withholding tax downward adjustment* under Annex B Section 4(12), irrespective of the quantum of such impact. Paragraph 4(b) has been included to ensure that "Article 7 characterisation cases" concerning withholding tax adjustments or assessment are included in the definition of "related issue" only to the extent that the underlying withholding tax adjustments or assessments have an impact on Amount A, since such an adjustment or assessment may have an impact through Article 5(2)(f) or Annex B Section 4(12) and without impacting the Elimination

Profit (or Loss) for that Covered Group with respect to the *covered jurisdiction* asserting or raising that adjustment or assessment.

782. A member of a Covered Group may file a MAP request concerning a “related issue” under Article 33 where it considers that an action, including one taken through the use of domestic anti-avoidance rules, results or will result in taxation not in accordance with the *covered tax agreement* and unresolved issues in cases that have already resulted in such taxation may lead to a dispute resolution request under Article 35 being filed. This does not create any implication that domestic anti-avoidance rules that are not meant to be covered by a *covered tax agreement* should now be considered covered. As acknowledged in the Commentary on Article 1 of the OECD Model or the UN Model, in the vast majority of cases, the application of anti-abuse rules will not result in taxation not in accordance with the *covered tax agreement*, and the application of anti-abuse rules found in domestic law will have an impact on how the provisions of the *covered tax agreement* are applied and thus, will generally not produce results conflicting with these provisions. Where a member of a Covered Group files a MAP request under Article 33 or an other available MAP provision contending that the application or proposed application of a domestic anti-avoidance rule by a *covered jurisdiction* is an action that is not in accordance with the provisions of a *covered tax agreement*, the *MAP competent authorities* would, in these situations, decide that the objection is not justified and not allow the case to proceed to the bilateral stage of MAP subject to the dispute resolution procedure under Article 35. For example, this is the case where the domestic anti-avoidance rule denies a treaty benefit in circumstances where obtaining the benefit would be contrary to the object and purpose of the *covered tax agreement*, as provided in the Commentary on Article 1 of the OECD Model or the UN Model. In this regard, it is noted that the obligation to provide access to the mutual agreement procedure under Article 33 or other available MAP provisions under the BEPS Action 14 minimum standard is distinct from the obligation to endeavour to resolve the case.

783. However, it is clarified that although the mutual agreement procedure under Article 33 and the dispute resolution procedure under Article 35 are restricted to *related issues* as defined in Article 34, the provisions of a mutual agreement procedure article of a *covered tax agreement* based on or equivalent to Article 25 (including paragraph 5) of the OECD Model or Article 25 (including paragraph 5 of Alternative B) of the UN Model would not be affected by this limited scope and these provisions would continue to be governed by the provisions of the *covered tax agreement* alone.

784. Paragraph 5 clarifies that some specific circumstances would not be covered in the definition of “related issue”. In this regard, paragraph 5(a) provides that adjustments related to the following issues are not “related issues”:

- an issue that concerns an adjustment to the profits of a transaction between members of a Group that are *regulated financial institutions*;
- an issue that concerns an adjustment to the profits of a transaction between members of a Group that are *extractives entities*;
- an issue that concerns members of a Group that is not a Covered Group in a Period under Annex C Section 5(6) or Section 5(7);
- an issue that concerns members of a Group that are located in an *autonomous domestic business jurisdiction*;
- an issue that concerns an adjustment to the profits of a transaction between members of a Group that are *extractives entities* and *regulated financial institutions*;

- an issue that concerns an adjustment to the profits of a transaction that only involves an *extractives segment* or a *regulated financial institution segment*;
- where Annex C Section 4 is applicable, an issue that concerns an adjustment to the profits of a transaction between a *segment entity* of an *extractives segment* and a *segment entity* of a *disclosed segment* that is not a *covered segment*;
- where Annex C Section 4 is applicable, a transaction between a *segment entity* of a *regulated financial institution segment* and a *segment entity* of *disclosed segment* that is not a *covered segment*;
- where Annex C Section 4 is applicable, a transaction between *segment entities* that are not part of a *covered segment*;
- where Annex C Section 4 is applicable, a transaction between *segment entities* of a *disclosed segment* that is not a *covered segment* in a Period under Annex C Section 5(6) or (7) as modified by Annex C Section 4;
- where Annex C Section 4 is applicable, a transaction between *segment entities* that are located in *autonomous domestic business jurisdictions*; or
- an issue that concerns an adjustment involving *defence revenues*.

785. Paragraph 5(b) then provides in addition that the following profit attribution issues are not “related issues”:

- an issue that concerns an adjustment to the profits attributed to a permanent establishment of a member of a Group (including the question of whether such a permanent establishment exists) that is a *regulated financial institution*;
- an issue that concerns an adjustment to the profits attributed to a permanent establishment of a member of a Group (including the question of whether such a permanent establishment exists) that is an *extractives entity*;
- an issue that concerns an adjustment to the profits attributed to a permanent establishment of a member of a Group (including the question of whether such a permanent establishment exists) that only affects revenue reported in an *extractives segment* or a *regulated financial institution segment*;
- where Annex C Section 4 is applicable, that is an adjustment to the profits attributed to a permanent establishment of an Entity that is not a member of a *covered segment*; or
- an issue that concerns an adjustment involving *defence revenues*.

786. These exclusions do not go further to generally exclude from the definition of “related issue” issues that concern any transaction that involves an entity that derives *extractives revenue* or that is a *regulated financial institution*. That is because, in applying these exclusions, the logic is to isolate the excluded revenues and profits; and treat the remaining part of the Group (or any *covered segments*) as if they were standalone groups, including by recognising transactions between the excluded part and the in-scope part. This means that a transaction involving the in-scope part, even if the counterparty to that transaction is itself excluded (such as where the upstream part of a *qualified extractives group* sells oil to a downstream part of the Group which is in scope), can affect the calculation of revenues and profits of that in-scope part and therefore affect Amount A. However, any adjustment that leads to a *disclosed segment* becoming or

not remaining a *covered segment* or any adjustment that would lead to a Group or a *disclosed segment* failing the test under Annex C Section 5(6) or (7) (as modified by Annex C Section 4 where Annex C Section 4 is applicable) for the Period in which the adjustment is asserted has been specifically excluded since the adjustment would then determine whether Amount A would apply or not and thus, the ability to obtain certainty on this point is important. Where a *scope certainty review* under the Convention has determined that a *disclosed segment* is a *covered segment* or not for a Period owing to the adjustment prior to a MAP request being filed, it is clear that the adjustment concerning the MAP request should always be considered a “related issue” covered by this exception. In other cases, the determination of whether a *disclosed segment* would be a *covered segment* or not would depend on the revenue of a *disclosed segment* and *segment adjusted profit before tax* reported by the *disclosed segment* and whether the adjustment would affect this reporting.

787. In addition, paragraph 5(c) includes an exception for assessments or adjustments that may have an impact on the Elimination Profit (or Loss) of a Covered Group, that are pursuant to a *special tax regime*. For the purpose of this exception, a “special tax regime” is defined as any tax that is covered under the material scope of a *covered tax agreement* that results in an additional tax liability connected to Extractive Revenues apart from the corporate income tax applicable. *Special tax regimes* of this nature are usually not covered under *covered tax agreements* by *covered jurisdictions*. However, some *covered jurisdictions* extend benefits under a *covered tax agreement* to these situations to consider the ability to provide relief from double taxation at their discretion under the mutual agreement procedure. Recognising that including these additional taxes in *covered tax agreements* involves particular sovereign domestic considerations, these *covered jurisdictions* have therefore limited the scope of mandatory binding dispute resolution for unresolved MAP cases arising from assessments under these taxes. Accordingly, this exception is designed to ensure that *special tax regimes* that are targeted towards creating additional tax liabilities connected to Extractive Revenues and are extended coverage under *covered tax agreements* by the *covered jurisdictions* concerned in the interest of avoiding double taxation (where this need not be the case in other *covered jurisdictions*) are not subject to the dispute resolution procedure that may result in these taxes being overturned simply owing to such extended coverage, to ensure consistency, and to respect the position of these *covered jurisdictions*.

Paragraph 6

788. Paragraph 6(a) clarifies that, for the purposes of Part V Section 3, the term “legally bound” means all circumstances in which a *MAP competent authority* must adhere to the decision of a court or administrative tribunal, regardless of whether the *MAP competent authority* was itself a party to the court or administrative tribunal procedure that resulted in the decision. A *MAP competent authority* is generally considered to be required to adhere to a court or administrative tribunal decision where they are required to do so under the law of a *covered jurisdiction*. However, in some cases, administrative guidance, such as a circular or notification or delegated legislation in a *covered jurisdiction* may be binding on the *MAP competent authorities* under the law and so, they would be considered to be required to adhere to a court or administrative tribunal decision where the administrative guidance makes such a decision binding as well. Nevertheless, it is clarified that this is intended to only cover situations where the administrative guidance is binding on the *MAP competent authorities* as a consequence of the law of the *covered jurisdiction* concerned and so, positions taken in administrative guidance arising from a provision of law that only allows the issuance of additional guidance without making the guidance binding would not be covered in this definition. Paragraph 6(a) would also encompass other circumstances in which a *MAP competent authority* must adhere to the outcomes of other processes related to a court or administrative tribunal procedure, such as a separate process required to be completed in connection with a court or administrative tribunal procedure in advance of that court or administrative tribunal procedure where they are required to do so, as a consequence of the law of the *covered jurisdiction* concerned, provided that the body undertaking this process has the authority to independently decide on the issue in a way that ensures

that the outcome is in line with the *covered tax agreement* as well. Such a separate process includes for example, a special process established by law for the review or reconsideration of an assessment of tax, which is independent from the audit and examination functions and that can only be accessed through a request by the taxpayer, is required to be initiated prior to the taxpayer being allowed to approach a court or tribunal and the outcome of which is legally binding on the *MAP competent authority* under the condition that the taxpayer explicitly agrees with the outcome. However, the term “legally bound” does not include within its scope circumstances where a *MAP competent authority* would follow a decision or outcome as a matter of administrative policy or practice but would not be obliged to adhere to the decision or outcome as a matter of law as described above.

789. Paragraph 6(b) defines the term “covered tax agreement” as an agreement, of which one of the purposes is the avoidance of double taxation with respect to taxes on income (whether or not other taxes are also covered) that is in force between two or more:

- Parties; and/or
- jurisdictions or territories to which the Convention applies pursuant to a declaration by a Party pursuant to Article 42(1),

including all amendments or modifications made to such agreement or its application through any subsequent protocol or another agreement, including the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, where applicable. It is also clarified that the term “covered tax agreement” includes all such agreements that are in force on the date of the adjustment or assessment that is the subject of a MAP request covered by Article 33, 35 or 36 i.e., filed under Article 33 or that leads to a dispute resolution procedure under Article 35 or 36. This is in line with the general practice in tax treaties to allow MAP under a tax treaty only if the tax treaty is in force for the year of adjustment.

790. It is also clarified that the term “covered tax agreement” does not include Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, the Convention on the elimination of double taxation in Connection with the Adjustment of Profits of Associated Enterprises (90/436/EEC), or any of their amending or succeeding instruments or acts of European Union law. The term also does not include an arrangement between a jurisdiction or territory described in Article 2(aa)(ii) and the State that is responsible for its international relations, or between two or more such jurisdictions or territories for which the same State is responsible.

791. In addition, although the definition of “covered tax agreement” in paragraph 6(d) is intended to make reference to agreements covered in this definition in general, it is clarified that Part V Section 3 is only intended to apply to *related issues*, as defined under Article 34, arising from a *covered tax agreement*. Accordingly, even if agreements that are mainly intended for other purposes such as exchange of information are considered included within the wording of paragraph 6(b) in strict terms, the MAP provision under Article 33 and the dispute resolution procedure under Article 35 would be applicable only to the extent that there are *related issues* satisfying the definition in Article 34.

792. Paragraph 6(d) defines the term “covered jurisdiction” as meaning a party to a *covered tax agreement* or a jurisdiction that is otherwise included in the territorial scope of such an agreement.

793. Since the scope of Articles 33 and 35 are connected to issues arising from a *covered tax agreement*, any reference to “MAP competent authorities” therein would assume the definition contained in the *covered tax agreement* relevant to the case at hand. Accordingly, paragraph 6(e) defines the term

“MAP competent authority” as referring to the definition under the relevant *covered tax agreement* applicable to the *related issue* concerned.

Article 35 – Resolution of disputes with respect to related issues

Paragraph 1

794. Paragraph 1 contains the core dispute resolution provision in Article 35. It provides that, where the *MAP competent authorities* are unable to reach an agreement on a case in the mutual agreement procedure within a period of two years, unresolved *related issues* arising from the case will, at the request of the member of a Covered Group who presented the case, be submitted to a dispute resolution panel in the manner described in Article 35. This dispute resolution process is available where, under the provisions of a *covered tax agreement* relating to the mutual agreement procedure, or under the provisions of Article 33, a member of a Covered Group has presented a case to the *MAP competent authority* of a *covered jurisdiction* on the basis that the actions of one or both of the *covered jurisdictions* have resulted for that member of a Covered Group in taxation not in accordance with the provisions of that *covered tax agreement*, and the *MAP competent authorities* are unable to resolve the case within a two-year period. As evident from paragraph 1, the dispute resolution procedure under Article 35 would thus apply to eligible unresolved MAP cases arising from Article 33 or under the MAP provision in a *covered tax agreement* and would only apply with respect to *related issues* that are unresolved in MAP as defined under Article 34 i.e. involving issues covered under provisions of a *covered tax agreement* based on or equivalent to Articles 5, 7 or 9 of the OECD Model or the UN Model and fulfilling the other criteria mentioned in the definition.

795. The start date for this two-year period is determined pursuant to paragraph 6 or 7, as the case may be. The *MAP competent authorities* may, however, agree to a different time period with respect to a particular case, provided that they notify the member of a Covered Group who presented the case of such agreement prior to the expiration of the two-year period referred to paragraph 1(a)(ii). This could be the case if, for example, the discussion of a case between the *MAP competent authorities* was nearing a resolution that could be expected to be achieved in an additional short period of time, thus avoiding the need for a dispute resolution panel process. This different time period with respect to a particular case could be longer or shorter than the two-year period referred to in paragraph 1(a)(ii), depending, for example, on the nature and complexity of the particular case. In cases in which the *MAP competent authorities* would mutually agree to extend the two-year period, the *MAP competent authorities* should keep in mind the objective of the dispute resolution mechanism to provide a timely resolution of *related issues*, that any such extension should accordingly not unreasonably delay such a resolution and provide the Covered Group with the mutually agreed duration of the extension. In cases in which the *MAP competent authorities* would mutually agree to shorten the two-year period referred to in paragraph 1(a)(ii), the member of the Covered Group concerned should be notified that they are eligible to initiate the dispute resolution procedure under Article 35 at that point of time. This is likely in a situation such as for example, where *MAP competent authorities* have an in-principle disagreement and agree prior to the expiry of the two-year period that further endeavours to discuss the case would not lead to a resolution in MAP.

796. Paragraph 1(b) then provides that the dispute resolution panel mechanism provided in Article 35 shall also apply to resolve any disagreement between *covered jurisdictions* regarding whether an issue is a *related issue*. The mandatory and binding resolution of such disagreements is essential to the proper functioning of the dispute resolution panel mechanism.

797. The provision in paragraph 1(a)(ii) of a two-year period before the member of the Covered Group may trigger the dispute resolution panel process does not preclude the *MAP competent authorities* from mutually agreeing that a member of a Covered Group may request the submission of unresolved *related issues* to a dispute resolution panel before the expiration of the two-year period. The choice to submit unresolved *related issues* to a dispute resolution panel would in all cases remain that of the member of a Covered Group.

798. Pursuant to paragraph 1(c), a request by a member of a Covered Group to submit unresolved *related issues* in a MAP case to a dispute resolution panel must be made in writing to the *MAP competent authority* of the *covered jurisdiction* of residence of that member of a Covered Group presented the MAP case. At the same time, the member of a Covered Group must send a copy of the request and all supporting documentation to the *MAP competent authority* of the other *covered jurisdiction*. Such a request should contain sufficient information to identify the case and must be accompanied by a number of different written statements identified in paragraph 1(c).

799. Paragraphs 1(c)(i) through 1(c)(iii) identify the following first group of three written statements:

- a written statement by the Entities of the Covered Group directly affected by the case that no decision on the same *related issues* has already been rendered by a court or administrative tribunal of the *covered jurisdictions*;
- a written statement by the Entities of the Covered Group directly affected by the case indicating whether one or more of the same *related issues* is pending before a court or administrative tribunal of either *covered jurisdiction*; and
- a written undertaking to notify the *MAP competent authorities* immediately upon the initiation by an Entity of the Covered Group directly affected by the case, following the request for a dispute resolution panel, of proceedings before a court or administrative tribunal of either *covered jurisdiction* with respect to one or more of the same *related issues*.

800. These written statements will aid the *MAP competent authorities* in applying paragraph 10 (which provides that any unresolved *related issue* arising from a MAP case otherwise within the scope of the dispute resolution panel process shall not be submitted to a dispute resolution panel if a decision on the *related issue* has already been rendered by a court or administrative tribunal of either of the *covered jurisdictions* and the *MAP competent authority* of the relevant *covered jurisdiction* is *legally bound* by that decision) and paragraph 11 (which provides that the dispute resolution panel process shall terminate if a decision on the *related issue* is rendered by a court or administrative tribunal of either of the *covered jurisdictions* while the dispute resolution panel process is in course and the *MAP competent authority* of the relevant *covered jurisdiction* is *legally bound* by that decision). They will also facilitate the application of other provisions governing the interrelationship of the dispute resolution panel process and litigation in a court or administrative tribunal (such as paragraphs 2 and 12). The undertaking to notify the *MAP competent authorities* immediately upon the initiation of proceedings before a court or administrative tribunal of either *covered jurisdiction* with respect to one or more of the same *related issues* is intended to ensure that the Covered Group promptly informs both *MAP competent authorities* of any proceeding initiated after the request for a dispute resolution panel, with a view to facilitating the *MAP competent authorities'* effective overall management of the MAP process.

801. Paragraph 1(c)(iv) next provides that the request should also include a written statement regarding confidentiality as provided in Annex G Section 4(3) from the Entities of the Covered Group directly affected by the case and their authorised representatives or advisors.

802. Pursuant to paragraph 1(c)(v), the request should in addition include a written statement by the member of a Covered Group that provides a brief explanation of how the issue involved in the request fulfils the definition of “related issue” under Article 34. In line with the definition, this explanation should clarify how the adjustment or assessment questioned in the request would:

- affect the elimination of double taxation for the Covered Group through a change in the *covered jurisdictions* required to provide Relief for Amount A taxation or a change in the Tier for the Allocation of the obligation to eliminate double taxation with respect to Amount A Profit of a *covered jurisdiction* for that Covered Group; or
- create a material impact on the Elimination Profit (or Loss) or Amount A Profit with respect to the *covered jurisdiction* asserting the assessment or adjustment for that Period through the materiality threshold in Article 34(3) or the backstop rule in Article 34(4) being fulfilled.

803. Finally, pursuant to paragraph 1(c)(vi), the request should include a written confirmation that the member of a Covered Group sent the request and all accompanying documentation (or a copy thereof) to the *MAP competent authorities* of both *covered jurisdictions*. This requirement is intended to ensure that both *MAP competent authorities* are promptly informed of the request for a dispute resolution panel.

804. For the purposes of Part V Section 3, “Entity of the Covered Group directly affected by the case” would mean the member of a Covered Group that presented the case and any other Entity of the Covered Group whose tax liability to either *covered jurisdiction* may be directly affected by the mutual agreement arising from that case.

805. To ensure the timely initiation of the dispute resolution panel process, paragraph 1(d) requires a *MAP competent authority* that receives a request to submit unresolved *related issues* to a dispute resolution panel without a confirmation that the member of a Covered Group also sent the request to the other *MAP competent authority* to send the other *MAP competent authority* a copy of the request and the accompanying documentation within a period of ten days after the receipt of the request.

806. In transfer pricing cases, two different requests for mutual agreement procedure may often be submitted by the associated enterprise resident in each *covered jurisdiction*, leading to two requests for establishing a dispute resolution panel under this paragraph. In these cases, each associated enterprise should send a copy of its request and supporting documentation to the other *MAP competent authority* as well under paragraph 1(c) in the interest of full transparency in the dispute resolution panel process. However, it is clarified that in these cases that involve two dispute resolution panel requests, where deadlines contained in Article 35 or Annex G make reference to a time period that starts from the date of the “request for a dispute resolution panel pursuant to Article 35(1)”, the date of the later dispute resolution panel request should be considered the starting point.

Paragraph 2

807. The dispute resolution mechanism provided for in Article 35 is intended to provide a mechanism for the *MAP competent authorities* to resolve *related issues* that may otherwise prevent agreement in mutual agreement procedure cases. Given that this mechanism is an extension of the mutual agreement procedure that serves to enhance the effectiveness of the procedure, paragraph 2(a) provides that the dispute resolution panel decision with respect to a *related issue* shall be implemented through the *MAP competent authority* mutual agreement concerning a particular MAP case. This means that following the decision of the dispute resolution panel, the *MAP competent authorities* shall reach a proposed *MAP competent authority* agreement that (except to the extent that paragraph 13 applies) reflects the outcome of the dispute resolution panel decision within 90 days of the communication of that decision to them.

Pursuant to Annex G Section 5(i), the *MAP competent authority* of the *covered jurisdiction* of residence of the member of a Covered Group that submitted the MAP request shall then have ten days (i.e. 100 days from the communication of the dispute resolution panel decision) to communicate to the member of a Covered Group that requested the dispute resolution panel proceeding the proposed *MAP competent authority* resolution of the case that reflects the outcome of the dispute resolution panel decision and request that member of a Covered Group confirm in writing that it and all Entities of the Covered Group directly affected by the case accept the proposed *MAP competent authority* resolution within 30 days.

808. Paragraph 2(b) provides for the final and binding effect of the dispute resolution panel decision, subject to four specific exceptions. The dispute resolution panel decision is final, meaning that, subject to paragraph 2(b)(ii), the dispute resolution panel decision cannot be changed, either by the *MAP competent authorities* or by the dispute resolution panel, unless the provisions of paragraph 13 apply to permit agreement on a different resolution. The dispute resolution panel decision is binding and the *MAP competent authorities* of the *covered jurisdictions* shall implement the mutual agreement concerning the MAP case that reflects the outcome of the dispute resolution panel decision notwithstanding any time limits in the domestic laws of the *covered jurisdictions* (pursuant to the MAP provisions of the *covered tax agreement*, or of Article 33).

809. In some cases, the MAP article of a *covered tax agreement* will provide time limits with respect to the implementation of any agreement reached through the mutual agreement procedure (for example, such a provision may provide that an agreement reached through the MAP shall be implemented notwithstanding domestic law time limits but only if the other *MAP competent authority* has been notified of the MAP case within a defined period from the end of the taxable year to which the case relates). The implementation of the mutual agreement that reflects the outcome of the dispute resolution panel decision pursuant to paragraph 2(b) would remain subject to any such provisions contained in a *covered tax agreement* where the member of a Covered Group elected to present its MAP case pursuant to the MAP provisions of the *covered tax agreement* rather than Article 33.

810. The four exceptions to the final and binding effect of the dispute resolution panel decision provided in paragraph 2(b) are as follows:

- if the member of a Covered Group that presented the case does not confirm that all Entities of the Covered Group directly affected by the case accept the proposed *MAP competent authority* resolution of the case that reflects the outcome of the dispute resolution panel decision within 30 days after the notification of the proposed *MAP competent authority* resolution pursuant to Annex G Section 5(i);
- if the dispute resolution panel decision is held to be invalid by a final decision of the courts of one of the *covered jurisdictions*;
- if an Entity of the Covered Group directly affected by the case pursues litigation in any court or administrative tribunal on the *related issues* that were resolved in the mutual agreement implementing the dispute resolution panel decision; and
- if a court of one of the *covered jurisdictions* delivers a decision legally binding on the *MAP competent authority* of that *covered jurisdiction* in the period between the finalisation of the *MAP competent authority* mutual agreement (following confirmation of the acceptance of the proposed *MAP competent authority* resolution concerning the case by the Entities of the Covered Group directly affected by the case) and the implementation of the mutual agreement by the *MAP competent authorities*.

811. The exception in paragraph 2(b)(i) addresses the situation in which an Entity of the Covered Group directly affected by the case does not accept the proposed *MAP competent authority* resolution of the case that reflects the outcome of the dispute resolution panel decision. In general, where a mutual agreement is reached before domestic remedies have been exhausted, *MAP competent authorities* may require, as a condition for the finalisation or conclusion of the agreement, that the person who presented the MAP case renounces the exercise of rights to domestic legal remedies with respect to the issues resolved through the mutual agreement on the case. Without such a renunciation, a subsequent court decision could prevent the tax authorities from implementing the agreement. Paragraph 2(b)(i) accordingly provides that an Entity of the Covered Group directly affected by the case will be considered not to accept the proposed *MAP competent authority* resolution of the case that reflects the outcome of the dispute resolution panel decision if that member does not withdraw from any domestic legal procedures or otherwise terminate any pending court or administrative proceedings in a manner consistent with the proposed *MAP competent authority* resolution within 30 days after notification of the proposed *MAP competent authority* resolution to the member of a Covered Group that requested the dispute resolution panel proceeding. A member of the Covered Group will also be considered not to accept the proposed *MAP competent authority* resolution where – to the extent allowed under the domestic law of the relevant *covered jurisdiction* – the member of the Covered Group does not file a waiver or otherwise formally forgo any right to bring the *related issues* resolved by the dispute resolution panel decision before a court or administrative tribunal. Where the proposed *MAP competent authority* resolution is not accepted, or is considered not to have been accepted, the case shall not be eligible for any further consideration by the *MAP competent authorities*.

812. Paragraph 2(b)(ii) provides that if a final decision of the courts of one of the *covered jurisdictions* holds that the dispute resolution panel decision is invalid, the request for a dispute resolution panel shall be considered not to have been made and the dispute resolution panel process shall be considered not to have taken place (except for purposes of Annex G Section 4(1) through (3), related to confidentiality, and Annex G Section 6(1), related to the costs of dispute resolution panel proceedings). The term “final decision”, used in paragraphs 2(b)(ii) and 8 and Annex G Section 6(1)(b)(i) describes a decision that is not merely an interim order or decision and that resolves definitively the substantive matters adjudicated by the court or administrative tribunal. The decision can be at any level of court in one of the *covered jurisdictions* so long as the decision is not subject to further appeal or other judicial or administrative recourse or is otherwise of binding nature.

813. Paragraph 2(b)(ii) does not provide independent grounds for the invalidation of a dispute resolution panel decision nor for the review of the substance of the dispute resolution panel decision. Instead, this provision recognises that under the domestic laws of some jurisdictions an administrative process like a dispute resolution panel proceeding may be subject to challenge, for example, where there has been a procedural or other failure that has materially affected the outcome of the dispute resolution panel proceeding. Paragraph 2(b)(ii) thus ensures that where a court of one of the *covered jurisdictions* invalidates a dispute resolution panel decision based on such existing domestic law rules, neither *covered jurisdiction* is bound to implement the decision. Based on the relevant *covered jurisdiction's* domestic law rules, grounds for a legal challenge to a dispute resolution panel decision may exist, for example, where such a failure is a result of the misconduct of a *MAP competent authority*, or of intentional conduct by members of the dispute resolution panel and/or members of a Covered Group and their advisors. These domestic law rules would determine the legal basis for the challenge, the parties with standing to make such a challenge and the court competent to adjudicate the challenge.

814. It is understood that paragraph 2(b)(ii) would apply only in exceptional circumstances. Depending on the relevant *covered jurisdiction's* domestic law rules, the procedural or other failures or other conduct to which paragraph 2(b)(ii) would apply could include:

- A *MAP competent authority's* failure to take appropriate steps to apply and monitor the impartiality or independence requirements applicable to members of a dispute resolution panel pursuant to Annex G Section 3;
- Any other failure by a *MAP competent authority* to adhere to the procedural requirements provided in Article 35, or other procedures agreed by the *MAP competent authorities*, if any; or
- Collusion between the member of the Covered Group and a *covered jurisdiction*, or between a member of the Covered Group or a *covered jurisdiction* and one or more members of the dispute resolution panel.

815. The final sentence of paragraph 2(b)(ii) confirms that the provision shall not itself provide a basis for a review of the substance of a dispute resolution panel decision by the courts of the *covered jurisdictions*. Paragraph 2(b)(ii) must be read together with paragraphs 2(b)(i) and (iii), pursuant to which a dispute resolution panel decision shall no longer be final or binding on the *covered jurisdictions* where a member of the Covered Group does not terminate all pending court proceedings with respect to *related issues* and (where possible under the domestic law of a *covered jurisdiction*) formally waive the right to bring the *related issues* before a court or administrative tribunal, or where a member of the Covered Group pursues litigation on the *related issues*.

816. Paragraph 2(b)(ii) also provides that, in the circumstances where it applies, the member of the Covered Group can make a new request for a dispute resolution panel process unless the *MAP competent authorities* agree that such a new request should not be permitted. Such a new request may be made without waiting for the passing of the period provided in paragraph 1(a)(ii), since that period will have already passed. It is expected that the *MAP competent authorities* would agree that such a request should not be permitted where the actions of the member of a Covered Group were the main reason for the invalidation of the dispute resolution panel decision.

817. Paragraph 2(b)(iii) provides that the dispute resolution panel decision shall not be final and binding on either *covered jurisdiction* if a member of the Covered Group pursues litigation in a court or administrative tribunal on *related issues* that were resolved in the mutual agreement implementing the dispute resolution panel decision. Paragraph 2(b)(iii) ensures that where a *covered jurisdiction* is not permitted under its domestic law to require a taxpayer to agree to forgo litigation as part of accepting a decision under the mutual agreement procedure, litigation cannot be used to achieve non-taxation or reduced taxation, for example by asserting that the dispute resolution panel decision binds one *covered jurisdiction* while the outcome of the litigation binds the other.

818. In the circumstances where paragraph 2(b)(ii) or (iii) would apply, the *MAP competent authorities* may have already taken steps to implement the mutual agreement reflecting the dispute resolution panel decision. In such cases, it is expected that *MAP competent authorities* would take the same steps to suspend or disapply the mutual agreement as they would in any other case in which a mutual agreement concluded by the *MAP competent authorities* was subsequently challenged in a court or administrative tribunal of the *covered jurisdictions*.

819. Paragraph 2(b)(iv) provides a last exception in cases where a court of one of the *covered jurisdictions* delivers a decision legally binding on the *MAP competent authority* of that *covered jurisdiction* in the period between the finalisation of the *MAP competent authority* mutual agreement (following the acceptance of the proposed *MAP competent authority* resolution by the Entities of the Covered Group directly affected by the case) and the implementation of the mutual agreement by the *MAP competent authorities*. Many *MAP competent authorities*, however, will not litigate an issue in court at the same time

as the issue is being considered in the mutual agreement procedure, thus reducing the likelihood that such cases will arise. In this regard, the definition for the term “legally bound” has been provided in Article 34(6).

820. Under paragraph 1(b), the dispute resolution panel mechanism will also apply to resolve any disagreement between *covered jurisdictions* regarding whether an issue that arises in a mutual agreement procedure case is a *related issue*. Paragraph 2(c) confirms that where a dispute resolution panel decides that an issue is not a *related issue*, this shall have no effect on the *MAP competent authorities*' obligation to endeavour to resolve the case in which that issue arises by mutual agreement under other available MAP provisions, nor on the application of any other mandatory binding dispute resolution mechanism arising from such provisions with respect to that issue.

821. It is acknowledged that in rare situations, a *MAP competent authority* may be legally prevented from implementing a dispute resolution panel decision with respect to the *related issue* in question owing to the hierarchy of laws under the domestic legal framework of the *covered jurisdiction* of that *MAP competent authority*. However, in these cases, both *MAP competent authorities* may also decide that the case should not move to a dispute resolution panel under Article 35(10)(b) owing to the case not being suitable for the dispute resolution panel process in their common view.

Paragraphs 3 through 7

822. Paragraphs 3 through 7 provide detailed rules to establish the start date of the period before a case becomes eligible for the dispute resolution panel mechanism. These provisions use a single point of reference (the member of the Covered Group who presented the MAP case) for purposes of determining the different milestones and deadlines provided in these paragraphs, with a view to promoting clarity and an efficient process.

823. The use of a single point of reference for purposes of these paragraphs does not, however, preclude a *MAP competent authority* from making requests for information to other Entities of the Covered Group directly affected by the case (for example, to other Entities of the Covered Group resident in the jurisdiction of that *MAP competent authority*). To ensure an effective MAP process, a *MAP competent authority* making such requests should inform the other *MAP competent authority* of those requests and promptly provide the other *MAP competent authority* with a copy of all responsive information it receives.

824. Paragraph 3 provides that the *MAP competent authority* of a *covered jurisdiction* that receives a request for a mutual agreement procedure as described in paragraph 1(a)(i) must, within 60 days of receiving the request, notify the member of a Covered Group who presented the case that the request has been received, and send a notification of the request to the other *MAP competent authority*. Where the MAP request does not include a statement confirming that the MAP request was also submitted to the other *MAP competent authority*, the notification must be accompanied by a copy of the request and all supporting documentation.

825. Under paragraph 4, each *MAP competent authority* must notify the member of a Covered Group that presented the case and the other *MAP competent authority* that it has received all information necessary to undertake substantive consideration of the case, or request additional information for that purpose from the member of a Covered Group that presented the case, within 90 days from the date on which it received the request.

826. For the purposes of Part V Section 3, the information necessary to undertake substantive consideration of a case includes the following specific items of information and documentation:

- The identity of the taxpayer(s) covered by the mutual agreement procedure request.

- The basis for the mutual agreement procedure request, identifying the specific tax treaty, the specific treaty article or articles the taxpayer considers are not being correctly applied by one or both *covered jurisdictions* (indicating which *covered jurisdiction* and the contact details of the relevant person(s) in that *covered jurisdiction*) and the mutual agreement procedure provision pursuant to which the request is made (i.e. Article 33 or the MAP provisions of a *covered tax agreement* or some other legal instrument).
- The facts of the case, including any documentation to support these facts (e.g. a copy of the final tax assessment, tax audit reports and any other documents issued by the tax authorities with regard to the *related issue(s)* in dispute), the taxation years or periods involved and the amounts involved (in all relevant currencies).
- An analysis of the issue(s) requested to be resolved through the mutual agreement procedure, including the taxpayer's interpretation of the application of the specific treaty provision(s), to support its basis for making a claim that the provision of the specific tax treaty was not correctly applied by one or both *covered jurisdictions*. This analysis shall be supported by relevant documentation.
- Where the mutual agreement procedure request was also submitted to the *MAP competent authority* of the other *covered jurisdiction*, a statement to this effect that identifies the taxpayer that made the request to the *MAP competent authority* of the other *covered jurisdiction* and that includes the date of that request, the *MAP competent authority* to which it was submitted, and a copy of the submission and all supporting documentation.
- Whether the mutual agreement procedure request was also submitted to another authority under another instrument that provides for a mechanism to resolve treaty-related disputes, including the date of any such submission, the name and designation of the authority to which it was submitted, and a copy of the submission and all supporting documentation.
- Whether any issue in the mutual agreement procedure case was previously dealt with (such as in an advance ruling, advance pricing arrangement, settlement agreement or a decision by any court or administrative tribunal or in other similar processes), including a copy of any such rulings, agreements or decisions.
- A statement confirming that all information and documentation provided in the mutual agreement procedure request is accurate and that the taxpayer will assist the *MAP competent authority* in its resolution of the issue(s) presented in the mutual agreement procedure request by furnishing any other information or documentation required by the *MAP competent authority* in a timely manner.
- A statement that the mutual agreement procedure case involves taxation connected with a *related issue*.
- Any other information or documentation required by either *MAP competent authority* in accordance with its published MAP guidance.

827. In transfer pricing cases that give rise to *related issues*, it is important for both *MAP competent authorities* to have a comprehensive view of the facts and circumstances of both parties to the intra-Group transaction. In a transfer pricing case, the facts of the case referenced in paragraph 7(c) should accordingly identify all relevant commercial or financial relations between the associated enterprises involved in the transaction as described in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax

Administrations (the Transfer Pricing Guidelines), including the accurate delineation of the actual transaction described in Section D.1 of Section I of the Transfer Pricing Guidelines.⁹

828. A *MAP competent authority* that requests additional information pursuant to paragraph 4(a) shall, at the same time as that request, notify the other *MAP competent authority* of the request. Where a *MAP competent authority* requests additional information pursuant to paragraph 4(b), paragraph 5 provides that after receiving such information, the *MAP competent authority* that requested the information shall provide the other *MAP competent authority* with a copy of all the additional information as soon as possible following its receipt. Then, within 90 days, the *MAP competent authority* that requested the information must notify the member of the Covered Group that presented the case and the other *MAP competent authority* either that it has received the requested information or that some of the requested information was not provided. Pursuant to paragraph 5(b), a notification that some of the requested information is missing shall only be sent, however, if the missing information is information necessary to undertake substantive consideration of the case. The *MAP competent authority* sending such a notification must also send the other *MAP competent authority* an explanation to this effect. Where, however, the member of a Covered Group that presented the case has provided a written explanation to the *MAP competent authority* requesting the missing information identified in the notification pursuant to this paragraph 5(b) detailing why it could not provide this information by the deadline prescribed by the *MAP competent authority* to provide that information in the notification, the missing information identified in the paragraph 5(b) notification is not information specifically listed in the published MAP guidance of the *covered jurisdiction* of that *MAP competent authority* and the notification provided under paragraph 5(a) has not been sent within 90 days following the notification sent pursuant to paragraph 5(b), the *MAP competent authority* that sent the paragraph 5(b) notification shall be treated as if it had made the notification referred to in paragraph 5(a) unless the *MAP competent authorities* mutually agree that the missing information is information necessary to undertake substantive consideration of the case. The written explanation should include the legal, commercial or practical reasons owing to which the information cannot be provided and should include reasons that go beyond convenience, a statement concerning the confidentiality of the requested information as a general rule or a reaffirmation of the filing position of the member of a Covered Group. Where possible, the member of a Covered Group providing a written explanation under this paragraph should also offer any alternative information that is available which may address the concerns of the jurisdiction in question. Nevertheless, since this deemed receipt of missing information only applies where the missing information is not specifically listed in the MAP Guidance of the *covered jurisdiction* of the requesting *MAP competent authority* (i.e. information falling under the “any other information” category), any missing information specifically listed in the MAP Guidance would not be deemed to be received in any circumstance and as detailed in paragraph 7, the start date would not be established until that missing information is actually received.

829. The start date of the period referred to in paragraph 1(a)(ii) depends on whether additional information is requested pursuant to paragraph 4(b).

830. Where neither *MAP competent authority* requests additional information, paragraph 6 provides that the start date is the earlier of:

- the date on which both *MAP competent authorities* have notified the member of a Covered Group who presented the case that all information necessary to undertake substantive consideration of

⁹ While it is recognised that some developing country Inclusive Framework members may also follow the United Nations Practical Manual on Transfer Pricing for Developing Countries (2017), this information should be helpful in such circumstances where the UN Manual follows a similar analytical framework and allows for similar conclusions as the OECD Transfer Pricing Guidelines.

the case was received (i.e., the date on which the second of the two *MAP competent authorities* has made that notification); and

- the date 90 days after the date of the earliest notification sent by one *MAP competent authority* to the *MAP competent authority* of the other *covered jurisdiction* pursuant to paragraph 3(b).

831. The date provided in paragraph 6(b) is intended to avoid blockages and ensures that there is a default start date in circumstances where either *MAP competent authority* fails to take one of the two actions required by paragraph 4 within 90 days of receipt of the request for a mutual agreement procedure (i.e., by the deadline for such action provided in paragraph 4).

832. Where additional information is requested, paragraph 7 provides that the start date is the latest date on which a *MAP competent authority* that requested additional information has notified the member of the Covered Group and the other *MAP competent authority* that the information has been received pursuant to paragraph 5(a) or on which a notification under paragraph 5(a) is deemed to have been made pursuant to paragraph 5(b). For these purposes, in circumstances where one or both *MAP competent authorities* send the notification referred to in paragraph 5(b), that notification shall be treated as a request for additional information pursuant to paragraph 4(b). If a *MAP competent authority* that requested additional information fails to notify the member of the Covered Group and the other *MAP competent authority* pursuant to paragraph 5 within 90 days of receiving the additional information, that *MAP competent authority* shall be treated as if it had not made a request for additional information for purposes of paragraphs 4 through 7. The date provided in paragraph 7 serves a similar purpose to the date provided in paragraph 6(b). It is intended to avoid blockages and ensures that there is a default start date in circumstances where a *MAP competent authority* does not send the notification provided in paragraph 5(a) or (b) within 90 days of the receipt of the additional information requested pursuant to paragraph 4(b).

833. Once the start date has been determined pursuant to paragraph 6 or 7, *MAP competent authorities* will not be precluded from making further requests for additional information during the MAP case development and discussion process, but any such further requests will have no effect on the running of the two-year period, except to the extent that the *MAP competent authorities* mutually agree, pursuant to paragraph 9, to extend the two-year period based on the failure by an Entity of a Covered Group directly affected by the case to provide in a timely manner any additional material information requested by either *MAP competent authority* after the start of that period.

834. The provisions defining the “start date” for purposes of the dispute resolution panel mechanism have no effect on the definition of “start date” for purposes of the BEPS Action 14 “MAP Statistics Reporting Framework”. These two definitions are intended to remain independent as they serve different purposes.

Paragraph 8

835. The mutual agreement procedure provided by tax treaty provisions based on Article 25(1) of the OECD Model and the UN Model is available to taxpayers irrespective of the judicial and administrative remedies provided by the domestic law of the *covered jurisdictions*. Most tax administrations, however, will require that one process take place before the other, to ensure that a taxpayer’s case will not proceed through both the mutual agreement procedure and a domestic court or administrative proceeding at the same time. To accommodate this approach, paragraph 8 provides that the period provided in paragraph 1(a)(ii) will stop running where a *MAP competent authority* decides to suspend the MAP referred to in paragraph 1(a)(i) because a case with respect to one or more of the same *related issues* is pending before a court or administrative tribunal, or is in a separate process required to be completed in connection with a court or administrative tribunal process in advance of that court or administrative tribunal process. The period will start running again when a final decision has been rendered by the court or administrative

tribunal or the case has been suspended or withdrawn. It should also be noted that, pursuant to paragraph 11, the dispute resolution process provided by Article 35 will terminate if a decision is rendered by the court or administrative tribunal during the period in which the dispute resolution process is suspended.

836. Paragraph 8 refers to “a separate process required to be completed in connection with a court or administrative tribunal process in advance of that court or administrative tribunal process” to ensure that the paragraph will appropriately apply in light of the different processes required in some jurisdictions’ legal systems in advance of a court or administrative tribunal process. In some jurisdictions, for example, a distinct administrative or other process, formally separate from the court or administrative tribunal process, may be required before the court or administrative tribunal process can begin. Such administrative or other processes are understood for these purposes to be processes that must take place before a court or administrative tribunal process can begin but that do not, by themselves, result in a final or binding resolution of the issues that will be decided by the court or administrative tribunal. These administrative or other processes would thus only be undertaken with the expectation that they will be followed by a court or administrative tribunal process. The *MAP competent authorities* of jurisdictions where such separate processes are required may wish to provide additional relevant information and clarification to treaty partner *MAP competent authorities* in bilateral discussions.

837. Paragraph 8 also requires that, in the circumstances described in the first sentence of the paragraph, the *MAP competent authority* that has suspended the mutual agreement procedure shall notify the other *MAP competent authority* as soon as possible of the suspension and its basis. Such notification is intended to ensure that the other *MAP competent authority* is promptly informed when the bilateral consideration of a MAP case will be suspended.

838. Paragraph 8 additionally provides that the period provided in paragraph 1(a)(ii) will stop running where the member of a Covered Group that presented the MAP case and both *MAP competent authorities* have agreed to suspend the mutual agreement procedure for reasons other than those described in the first sentence of paragraph 8. The period will start running again once that suspension has been lifted. This could apply, for example, where the member of a Covered Group and the *MAP competent authorities* have agreed to suspend the mutual agreement procedure because the outcome of another pending MAP or court case involving other Entities of the Covered Group, or of an audit of another Entity of the Covered Group, will be relevant to the analysis and resolution of the MAP case in which the *related issues* arise. Such circumstances could arise where different members of the Covered Group are involved in a series of integrated controlled transactions.

Paragraph 9

839. In some cases, after the member of a Covered Group has provided the information needed to undertake substantive consideration of the MAP case, the *MAP competent authorities* may need to request additional information from the member of a Covered Group. For example, after the period provided in paragraph 1(a)(ii) has begun and after further analysis based on working the case, a *MAP competent authority* may determine that it needs additional information in respect of a particular structure or transaction in order to reach agreement on how to resolve an issue. In such cases, a failure by an Entity of the Covered Group directly affected by the case (i.e., the member of a Covered Group who made the initial request for a mutual agreement procedure or another Entity of the Covered Group whose tax liability is directly affected by the case) to provide such additional information in a timely manner may delay or prevent the *MAP competent authorities* from being able to resolve the case. To address this, paragraph 9(a) provides that the period provided in paragraph 1(a)(ii) shall be extended where both *MAP competent authorities* agree that an Entity of the Covered Group directly affected by the case has failed to provide in a timely manner any additional material information requested by either *MAP competent authority*.

840. Where a request for additional information is made **before** the period provided in paragraph 1(a)(ii) has begun, it is expected that the *MAP competent authority* making that request would only notify the member of the Covered Group and the other *MAP competent authority* pursuant to paragraph 5(a) – thereby triggering the start of the two-year period provided in paragraph 1(a)(ii) – when it had received a complete response to its request for additional information. Paragraph 9 thus does not provide for the extension of the two-year period in these circumstances.

841. Where a request for additional information is made **after** the start of the period provided in paragraph 1(a)(ii), a late response to such a request shall extend the two-year period for an amount of time equal to the period beginning on the date on which the information was requested and ending on the date on which that information was ultimately provided.

842. Under paragraph 4, a *MAP competent authority* may request additional information necessary to undertake substantive consideration of the case within 90 days after it receives the request for a mutual agreement procedure. Where such additional requests for information are made, paragraph 7 then provides that the start date of the case for purposes of paragraph 1 will be the latest date on which a *MAP competent authority* that requested additional information has notified the member of a Covered Group who presented the case and the other *MAP competent authority* that it has received the information pursuant to paragraph 5(a). Paragraph 9(a) applies with respect to requests for additional information made after the period provided in paragraph 1(a)(ii) has already started. Paragraph 9(a) permits the period provided in paragraph 1(a)(ii) to be extended where the *MAP competent authorities* mutually agree that an incomplete response to a request for additional information made after the start of that period constitutes a failure to timely provide additional material information. In circumstances where the member of a Covered Group fails altogether to respond to such a request for additional material information after a reasonable period, the *MAP competent authorities* should mutually agree on an appropriate response, which could include suspending the two-year period or deeming the member of a Covered Group to have withdrawn its mutual agreement procedure request.

843. Paragraph 9(a) is relevant only for the purpose of determining whether the period provided in paragraph 1(a)(ii) should be extended in cases where a member of a Covered Group fails to provide additional information in a timely manner. It does not change the requirements under Article 25(1) and a *covered jurisdiction's* MAP guidance for the acceptance of a MAP case or the Article 25(2) obligation to seek to resolve the MAP case where *MAP competent authorities* have sufficient information to determine that the objection raised in the MAP request is justified.

844. In some circumstances, uncooperative conduct by a member of the Covered Group before or after filing a mutual agreement procedure request may undermine or impede a tax administration's examination of the Periods concerned by the case or the *MAP competent authorities'* substantive consideration and resolution of the case. Such conduct may prevent the start of the two-year period provided in paragraph 1(a)(ii) where it includes a failure to provide the *MAP competent authorities* with information needed to undertake substantive consideration of the MAP case. It is possible, however, that the *MAP competent authorities* become aware of such conduct only after the two-year period provided in paragraph 1(a)(ii) has already started. Paragraph 9(b) provides that the *MAP competent authorities* may in these circumstances mutually agree to extend or suspend the two-year period. Where the *MAP competent authorities* intend to apply paragraph 9(b), they are required to notify the member of a Covered Group that presented the MAP case.

Paragraphs 10 and 11

845. In some jurisdictions a mutual agreement concluded by the *MAP competent authority* cannot override the decision of a court or administrative tribunal or a separate process required to be completed

in connection with a court or administrative tribunal process in advance of that court or administrative tribunal process in that jurisdiction as a matter of law. In these jurisdictions, the *MAP competent authority* would be unable to implement a mutual agreement reflecting a dispute resolution panel decision to the extent of any conflict or inconsistency between the decision of the court or administrative tribunal and the dispute resolution panel decision. The *MAP competent authority* of the other jurisdiction involved in the MAP case, however, would be bound by the dispute resolution panel decision and would be obliged to implement the mutual agreement reflecting the dispute resolution panel decision. In such circumstances, inconsistent treatment of the contested matters in the two *covered jurisdictions* would likely result in either double taxation or non-taxation. Paragraph 10(a) addresses this issue by ensuring that the dispute resolution panel process cannot be pursued with respect to *related issues* that have been resolved through such a decision before submission of the *related issues* to a dispute resolution panel in certain circumstances.

846. Paragraph 10(a) provides that an unresolved *related issue* shall not be submitted to a dispute resolution panel if a decision on that *related issue* has already been rendered by a court or administrative tribunal of either *covered jurisdiction* and the *MAP competent authority* of the *covered jurisdiction* of that court or administrative tribunal is *legally bound* by the decision.

847. Article 34 (6)(a) of Article 34 provides the definition of the term “legally bound” for the purposes of Part V Section 3.

848. Although the Convention does not provide for general exclusions from the scope of the dispute resolution panel process in Article 35, paragraph 10(b) allows *MAP competent authorities* to mutually agree to exclude from the scope of the dispute resolution panel process cases that are not suitable for the dispute resolution panel process in their common view on a case-by-case basis. This provision would usually be applied, for instance, where one of the *covered jurisdictions* has excluded a category of cases from the scope of mandatory binding dispute resolution under other available MAP provisions already and the other *covered jurisdiction* would request for the exclusion of a specific case from the dispute resolution panel process under the Convention on the basis that this case is analogous to those falling under the category of cases excluded from the scope of mandatory binding dispute resolution under those other available MAP provisions. The *MAP competent authority* of the first *covered jurisdiction* should, in these cases, consider whether the justification for those exclusions apply to the case in question, keeping in mind the possibility of creating a level playing field in the same or similar circumstances, and extend these exclusions in appropriate cases, where allowed under the domestic law of that *covered jurisdiction*. Nevertheless, Annex G Section 2 also allows the *MAP competent authorities* to agree to exclude a category of cases from the scope of the dispute resolution procedure under Article 35 through a *MAP competent authority* agreement, as noted in paragraph 2699.

849. Paragraph 11 complements paragraph 10(a) by providing that the dispute resolution panel process will terminate if a decision concerning an unresolved *related issue* is rendered by a court or administrative tribunal of or in a separate process required to be completed in connection with a court or administrative tribunal process in advance of that court or administrative tribunal process in one of the *covered jurisdictions* at any time after a request for a dispute resolution panel has been made. Like paragraph 10(a), paragraph 11 applies only where the *MAP competent authority* of the *covered jurisdiction* of that court or administrative tribunal or similar process is *legally bound* by the decision. Paragraph 11 provides two distinct rules that apply in different circumstances:

- If the dispute resolution panel ***has not yet delivered its decision***, the dispute resolution panel process will terminate. As provided in paragraph 12, the MAP case shall not be eligible for any further consideration by the *MAP competent authorities*, except to the extent mutually agreed by the *MAP competent authorities*.

- If the decision is rendered **after the dispute resolution panel has delivered its decision**, notwithstanding paragraph 2(b), the dispute resolution panel decision shall not be final and binding on both *covered jurisdictions*, and any mutual agreement concerning the case that reflects the outcome of the dispute resolution panel decision shall not be implemented. Paragraph 11(b) would apply both before and after the communication to the member of the Covered Group of the proposed *MAP competent authority* resolution reflecting the dispute resolution panel decision. In this circumstance, the MAP case shall not be eligible for any further consideration by the *MAP competent authorities*.

850. Both paragraphs 10(a) and 11 are intended to avoid a possible conflict between the results of the dispute resolution panel process and the decision of a court or administrative tribunal or other similar process, in circumstances where a *MAP competent authority* cannot override the decision of a court or administrative tribunal or other similar process of that jurisdiction as a matter of law. As explained above, in such circumstances a *MAP competent authority* would be unable to implement the results of the dispute resolution panel process through a mutual agreement if those results conflicted with a court decision in that jurisdiction on the same matter.

851. In those *covered jurisdictions* where *MAP competent authorities* may conclude mutual agreements deviating from such decisions and in particular domestic court decisions, these paragraphs will not preclude members of Covered Groups from requesting a dispute resolution panel in the cases described in paragraph 10(a), nor will they trigger the application of paragraph 11. *MAP competent authorities* may wish to clarify the operation of paragraphs 10(a) and 11 in bilateral consultations. In particular, in some *covered jurisdictions* the *MAP competent authority* would be precluded from maintaining taxation that a court had decided was not in accordance with the Convention but would not be prevented from granting relief from taxation notwithstanding a court decision that such taxation was in accordance with the Convention.

Paragraph 12

852. Recognising that the purpose of a dispute resolution panel under Article 35 is to resolve disputes between the *MAP competent authorities* with respect to *related issues* that arise from mutual agreement procedure cases, paragraph 12 provides for the consequences of certain events relevant to the resolution of these disputes but external to the dispute resolution panel proceeding itself. The two subparagraphs of paragraph 12 deal separately with the consequences for the dispute resolution panel and for the *MAP competent authorities'* consideration of the underlying mutual agreement procedure case, which may not be the same in all circumstances.

853. Paragraph 12(a) first provides that the dispute resolution panel proceeding will terminate if, during the dispute resolution panel process (at any time after a request for a dispute resolution panel has been made and before the dispute resolution panel has delivered its decision) any one of the following events occurs:

- the *MAP competent authorities* come to a mutual agreement to resolve the case;
- the member of a Covered Group who presented the case withdraws either its request for a dispute resolution panel or its request for a mutual agreement procedure;
- a decision concerning the case is rendered in one of the *covered jurisdictions* before the dispute resolution panel has delivered its decision to the *MAP competent authorities* and the *MAP competent authority* of the *covered jurisdiction* of that court or administrative tribunal is *legally bound* by the decision, as provided in paragraph 11(a); or

- any member of the Covered Group or any of its authorised representatives or advisors breaches the written confidentiality agreement required by Annex G Section 4(3).

854. Paragraph 12(b) then provides that, where the dispute resolution panel proceeding with respect to a case has been terminated pursuant to paragraph 12(a), the case shall not be eligible for any further consideration by the *MAP competent authorities*, except to the extent mutually agreed by the *MAP competent authorities* in specifically identified circumstances. Whilst the mutual agreement procedure with respect to a case would be terminated in the event of a taxpayer's withdrawal of its MAP request, the *MAP competent authorities* may consider that further consideration of the case is appropriate in certain other circumstances.

855. A first circumstance where further *MAP competent authority* consideration of the MAP case may be appropriate is where the member of the Covered Group withdraws its request for a dispute resolution panel but not the underlying MAP request. Such a withdrawal could occur, for example, if a member of a Covered Group requested a dispute resolution panel but soon thereafter was informed by the *MAP competent authorities* that they would reach an agreed resolution of the MAP case shortly. Although the dispute resolution panel proceeding would terminate pursuant to paragraph 12(a)(i) upon a *MAP competent authority* mutual agreement, the *MAP competent authorities* would continue to be bound by the provisions of Article 35 to take certain actions by fixed deadlines until that mutual agreement was concluded. *MAP competent authorities* may thus prefer to ask the member of the Covered Group to withdraw the request for a dispute resolution panel in view of an imminent mutual agreement, the date of which they will not know with absolute certainty, in order to avoid being obliged to set up a dispute resolution panel that will likely not be used. Further *MAP competent authority* consideration of the MAP case would only occur in these circumstances where both *MAP competent authorities* agreed it was appropriate.

856. A second circumstance where further *MAP competent authority* consideration of the MAP case may be appropriate is where the dispute resolution panel proceeding is terminated as a result of a court decision legally binding the *MAP competent authority* of one *covered jurisdiction*. Such further *MAP competent authority* consideration would permit the *MAP competent authority* of the other *covered jurisdiction* to evaluate whether it would agree to provide relief consistent with that court decision (such as by providing a corresponding adjustment) in the context of the mutual agreement procedure.

Paragraph 13

857. Notwithstanding paragraph 2, paragraph 13 allows the *MAP competent authorities* to depart from the dispute resolution panel decision and to agree on a different resolution within 90 days after the decision has been delivered to them. The 90-day time period is aligned with the period provided in paragraph 2(a) for *MAP competent authorities* to reach a mutual agreement concerning the case that reflects the outcome of the dispute resolution panel decision. Some jurisdictions consider that paragraph 13 would be unlikely to be applied where a last-best offer approach to decision-making is used by dispute resolution panels, given that the decision of the dispute resolution panel will be the position of one of the two *MAP competent authorities*. Other jurisdictions, however, consider that it is useful to provide *MAP competent authorities* with the flexibility afforded by the paragraph.

Paragraphs 14 and 15

858. Paragraphs 14 and 15 describe the interactions between the provisions of Article 35 and other available processes where the *covered tax agreement* contains a mandatory binding dispute resolution mechanism for unresolved MAP cases or where the EU tax dispute resolution Directive or the EU Arbitration Convention (which allow for such a mechanism as well) applies. The purpose of such provisions,

like the purpose of Article 35, is to resolve disputes efficiently and effectively and so, paragraph 14 is intended to avoid duplication of efforts.

859. Paragraph 14 provides that any unresolved *related issue* arising from a case presented pursuant to the mutual agreement procedure provisions of a *covered tax agreement* and otherwise within the scope of the dispute resolution panel process under Article 35 shall not be submitted to a dispute resolution panel where that *covered tax agreement* provides that a mandatory binding dispute resolution mechanism, such as an arbitration panel or similar body, is required to be set up, upon the request of the member of the Covered Group or automatically, after a set time period to resolve unresolved issues arising from a mutual agreement procedure case or where the Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union (or a domestic legislation implementing the same), the Convention on the elimination of double taxation in Connection with the Adjustment of Profits of Associated Enterprises (90/436/EEC), or any of their amending or succeeding instruments or acts are applicable. This means that where MAP requests arise from existing provisions in *covered tax agreements* containing a mandatory binding dispute resolution mechanism for unresolved MAP cases or the EU tax dispute resolution Directive or the EU Arbitration Convention, Article 35 would, subject to paragraph 15, not be applicable, even if these existing provisions allow for specific types of cases to be excluded from the scope of the mandatory binding dispute resolution mechanism contained therein. Given the definition of the term “covered tax agreement” in Article 34(6)(b), all references in paragraph 14 to a “covered tax agreement” refer to provisions of such agreement as they may have been modified or amended by any subsequent protocol or another agreement, or as their application may have been modified by the BEPS Multilateral Instrument, regardless of whether agreements have been entered into between *MAP competent authorities* concerning the mode of application of these provisions.

860. However, paragraph 15 provides that, notwithstanding paragraph 14, the *covered jurisdictions* may mutually agree that the dispute resolution panel process provided in Article 35 shall apply to resolve *related issues* even where that *covered tax agreement* provides for a mandatory binding dispute resolution mechanism after a set time period.

861. To provide clarity with respect to the relationship between the mechanism in Part V Section 3 and the mechanism provided under the other instrument, such an agreement must specify the date from which it is effective. This would generally be the case with any international agreement. The agreement must also specify whether the other instrument shall remain applicable to unresolved *related issues* (it is expected that *covered jurisdictions* would generally choose to apply only one dispute resolution mechanism with respect to *related issues*). To promote greater certainty, the *MAP competent authorities* of the relevant *covered jurisdictions* may wish to consider providing additional guidance to specify the MAP disputes with respect to which any agreement pursuant to paragraph 15 shall apply.

862. Some *covered jurisdictions* may prefer to apply the dispute resolution panel process provided in Article 35 in light of the design features of this process that ensure the timely resolution of disputes with respect to *related issues*. An agreement concluded pursuant to paragraph 15 may apply to all MAP cases that involve a *related issue* arising under a *covered tax agreement* or to a particular MAP case. It is expected, however, that a paragraph 15 agreement to apply the mechanism in Article 35 to unresolved *related issues* in a single MAP case would be rare.

863. However, *covered jurisdictions* may not agree to apply the dispute resolution panel process provided in Article 35 where the mutual agreement case concerned has been presented under the Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union (or a domestic legislation implementing the same), the Convention on the elimination of double taxation in Connection with the Adjustment of Profits of Associated Enterprises (90/436/EEC), or any of their amending or succeeding instruments or acts.

864. Article 35 does not address the application of MAP arbitration provisions of based on or equivalent to Article 25(5) of the OECD Model or Article 25(5) (Alternative B) of the UN Model in the context of a MAP case presented pursuant to Article 33. This is because, by their terms, such MAP arbitration provisions apply only with respect to MAP cases presented pursuant to paragraph 1 of the MAP article of the relevant tax treaty. A MAP case presented pursuant to Article 33 would thus fall outside the scope of these MAP arbitration provisions.

Article 36 – Elective binding dispute resolution panel mechanism

Paragraphs 1 to 2

865. Article 36 provides for an elective binding dispute resolution panel mechanism that reflects the Pillar One tax certainty component of the October Statement, which provides in the relevant part:

“An elective binding dispute resolution mechanism will be available only for issues related to Amount A for developing economies that are eligible for deferral of their BEPS Action 14 peer review¹ and have no or low levels of MAP disputes. The eligibility of a jurisdiction for this elective mechanism will be reviewed regularly; jurisdictions found ineligible by a review will remain ineligible in all subsequent years.”

“Footnote 1: The conditions for being eligible for deferral of the BEPS Action 14 peer review are provided in paragraph 7 of the current Action 14 Assessment Methodology published as part of the Action 14 peer review documents.”

866. At the time of the October Statement, paragraph 7 of the Action 14 Assessment Methodology provided that the deferral of a jurisdiction’s Action 14 peer review was available as follows: “...the MAP Forum should defer the review of any such member that is a developing country and is not an OECD or G20 country if that member has not yet encountered meaningful levels of MAP requests and there is no feedback from other members of the FTA MAP Forum indicating that the jurisdiction’s MAP regime requires improvement....”

867. Article 36 reflects the language of the October Statement and establishes a set of four objective criteria that define the *covered jurisdictions* eligible to use an elective binding dispute resolution mechanism in the place of the mandatory binding dispute resolution mechanism provided in Article 35. Only where a *covered jurisdiction* satisfies all four of these criteria will it be considered to be eligible to use the elective binding dispute resolution mechanism.

868. The first criterion in Article 36(1)(a) identifies the “developing economies” eligible to use the elective mechanism as those *covered jurisdictions* classified by the World Bank as a low- or middle-income jurisdiction by reference to *gross national income* per capita, calculated using the World Bank Atlas method, as determined for the relevant period. For these purposes, paragraph 1(a) specifies that the relevant *gross national income* per capita ratio is that determined for the most recent period for which such data is published that precedes the date of entry into effect of Part V Section 3 of the Convention for that *covered jurisdiction*, or that precedes the date of the most recent review provided for in paragraph 4, whichever is later.

869. The second criterion in Article 36(1)(b) is that the *covered jurisdiction* is not a member of the Organisation for Economic Cooperation and Development nor a member country of the G20. This criterion is evaluated on the date of entry into effect of Section 3 of Part V of the Convention for that *covered jurisdiction*, or on the date of the most recent review provided for in paragraph 4, whichever is later.

870. The third criterion in Article 36(1)(c) is that the *covered jurisdiction* has not received feedback from other members of the Organisation for Economic Cooperation and Development Forum on Tax Administration MAP Forum (FTA MAP Forum) that its policies or practices concerning the mutual agreement procedure require improvement. For a *covered jurisdiction* that has had its Base Erosion and Profit Shifting (BEPS) Action 14 peer review deferred, the relevant periods for such feedback are any period following the most recent deferral of that *covered jurisdiction's* BEPS Action 14 peer review. Where a *covered jurisdiction's* BEPS Action 14 peer review has not been deferred, the relevant periods for such feedback are the period covered by that *covered jurisdiction's* most recent BEPS Action 14 peer review and any subsequent periods.

871. The last criterion in Article 36(1)(d) is that the *covered jurisdiction* has had no or low levels of mutual agreement procedure disputes. Paragraph 2 then defines expressly when a *covered jurisdiction* shall be considered to have “had no or low levels of mutual agreement procedure disputes”: where the three-year average number of attribution/allocation mutual agreement procedure cases in its inventory at the end of the year, as determined by the mutual agreement procedure Statistics submitted by it annually, is below 10 cases. For the purpose of computing this average,

- the three-year average shall initially be computed using the mutual agreement procedure Statistics for the three years that immediately precede the date of entry into effect of Part V Section 3 of the Convention for that *covered jurisdiction*; and
- the three-year average shall be computed during the review provided for in paragraph 4 using the mutual agreement procedure Statistics for the three years that immediately precede the date of that review.

These rules related to the computation of the three-year average are tied to the review of the eligibility of a *covered jurisdiction* for the elective binding mechanism every three years by the FTA MAP Forum pursuant to paragraph 4.

872. This quantitative criterion refers to “attribution/allocation cases”, a defined category of mutual agreement procedure cases used for purposes of the Action 14 Mutual Agreement Procedure Statistics Reporting Framework. It does so to provide an objective standard that reflects a *covered jurisdiction's* experience with mutual agreement procedure cases of the type in which *related issues* will arise (i.e., transfer pricing and business profits disputes). The quantitative criterion also uses an averaging mechanism to mitigate the impact of significant fluctuations in a *covered jurisdiction's* mutual agreement procedure case inventory.

Paragraph 3

873. Paragraph 3 then establishes the relationship between the deferral of a *covered jurisdiction's* BEPS Action 14 peer review and its eligibility to use the elective binding dispute resolution mechanism provided by Article 36. Paragraph 3 provides that the determination pursuant to paragraphs 1 and 2 is intended to be self-standing and reflect the criteria referred to in the October Statement, without reference to the BEPS Action 14 Peer Review Documents themselves. Paragraph 3 also makes clear that there is no link between the eligibility for the elective mechanism and any possible future changes to the criteria for deferral of a jurisdiction's Action 14 peer review.

Paragraph 4

874. Paragraph 4 next provides for the periodic review of *covered jurisdictions*' eligibility for the elective binding mechanism under the criteria in paragraphs 1 and 2, with a view to ensuring that a determination of eligibility continues to reflect a *covered jurisdiction*'s circumstances. This review will be carried out every three years by the FTA MAP Forum. As provided in the October Statement, any *covered jurisdiction* that is found to not meet the criteria in paragraphs 1 and 2 during a periodic review shall be ineligible for the elective binding mechanism provided in Article 36 in all subsequent years.

Paragraph 5

875. Paragraph 5 implements the elective binding dispute resolution mechanism by providing that this mechanism shall apply *mutatis mutandis* the process provided in Article 35, with the substitution of alternative language in the place of Article 35 (1)(a), (d) and (2)(c) to reflect the elective nature of the mechanism. In particular, the dispute resolution panel is elective in that both *MAP competent authorities* must mutually agree to use the dispute resolution panel before such a panel will be used to resolve a *related issue*. Once the *MAP competent authorities* have so mutually agreed, the dispute resolution panel will proceed as provided under Article 35, with any necessary changes to the provisions of Article 35 to reflect the circumstance that the process has been triggered by a *MAP competent authority* mutual agreement, rather than a request from a member of a Covered Group.

876. In particular, paragraph 5 reflects the following differences as compared to Article 35(1) and 36(2):

- The flush language at the end of paragraph 5(a) provides for the initiation of a dispute resolution panel proceeding “if the member of a Covered Group requests **and the MAP competent authorities mutually agree**”. The corresponding language in Article 35(1)(a) provides for the initiation of a dispute resolution panel proceeding “if the member of a Covered Group requests”.
- The flush language at the end of paragraph 5(a) refers to “Article 35” and “Annex G Section 2”; the corresponding references in Article 35(1)(a) are to “this Article” and “Annex G Section 2”.
- Paragraph 5(b) contains an additional language not included in Article 35(1)(d) and that is required for the operation of the elective binding mechanism.
- Paragraph 5(c) refers to “[t]he absence of a **MAP competent authority mutual agreement to submit an issue to a dispute resolution panel**”, rather than to “[a] dispute resolution panel decision that an issue is not a *related issue*” because a *covered jurisdiction* eligible to use the elective mechanism would generally be expected not to agree to submit a mutual agreement procedure issue to a dispute resolution panel pursuant to the rule in Article 36(5)(a) if it did not agree that the issue was a *related issue*.
- Paragraph 5(d) replaces the provisions of Article 35(14) and (15) with an alternative rule to govern the interaction between the provisions of Article 36 and the provisions of a bilateral or multilateral convention that provides for a mandatory binding dispute resolution mechanism, such as an arbitration panel or similar body, with respect to unresolved issues that arise from a mutual agreement procedure case. This rule reflects the elective nature of the mechanism provided by Article 36, which makes it appropriate that the interactions of the elective binding mechanism with a mandatory binding dispute resolution mechanism that could apply to unresolved *related issues* should be determined by the *MAP competent authorities* of the relevant *covered jurisdictions* by mutual agreement.

Section 4 – Exchange of Information and international cooperation

Article 37 – Exchange of Information and international cooperation

Paragraph 1

877. The main rule concerning the exchange of information under the Convention is contained in the first sentence of the paragraph. The Parties shall exchange any such information as is foreseeably relevant for the administration or enforcement of the Convention or the domestic laws concerning taxes imposed in accordance with Article 4 or relieved in accordance with Article 9. The standard of “foreseeable relevance” ensures consistency with other exchange of information provisions, such as those contained in the Convention on Mutual Administrative Assistance in Tax Matters and Article 26 of the OECD Model or the UN Model, and is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that Parties are not at liberty to engage in “fishing expeditions” or to request information that is unlikely to be relevant for the proper administration and enforcement of the Convention or the domestic laws concerning taxes imposed in accordance with Article 4 or relieved in accordance with Article 9. As such, the Commentaries to the Convention on Mutual Administrative Assistance in Tax Matters and Article 26 of the OECD Model or the UN Model can be used as interpretative guidance as a complement to this Explanatory Statement.

878. This paragraph does furthermore not intend to limit the exchange of information provisions of bilateral or multilateral tax treaties or other legal instruments for the exchange of information, including the Convention on Mutual Administrative Assistance in Tax Matters, to the extent that the provisions of such treaties or instruments also cover tax matters set out in the Convention. In such instances, the Parties should decide whether it is most appropriate, given the case-specific circumstances, to rely on paragraph 1 or on the exchange of information provisions in the bilateral or multilateral tax treaties or other legal instruments for the exchange of information, including the Convention on Mutual Administrative Assistance in Tax Matters.

879. The five main methods of exchanging information are the following:

- exchange on request, that is to say the furnishing by the requested Party of information relating to a particular case to an applicant Party which has specifically requested it;
- automatic exchange, that is to say the systematic sending of information concerning specified items of income or capital from one Party to another;
- spontaneous exchange, that is to say the passing on of information obtained during examination of a taxpayer's affairs or otherwise, which might be of interest to the receiving Party;
- simultaneous tax examination, that is to say the furnishing of information obtained in the course of the simultaneous examination in each Party concerned, on the basis of an arrangement between two or more Competent Authorities of the tax affairs of a person, or persons in which these Parties have a common or related interest;

- tax examination abroad, that is to say the obtaining of information through the presence of representatives of the tax administration of the applicant Party at an examination of a tax matter in the requested Party.

880. Paragraph 1 does not restrict the possibilities of exchanging information to the five methods mentioned above. In general, the manner in which exchange of information will in the event be effected can be decided upon by the Parties, acting through their Competent Authorities.

Paragraph 2

881. This paragraph establishes the ways in which Parties communicate with each other for purposes of exchange of information and international cooperation under this Article and opens up the possibility of mutual agreements of Competent Authorities.

882. While Article 37 contains the key provisions that govern the exchange of information and international cooperation for the administration and enforcement of the Convention, the precise way in which it is administered and the formalities to be taken into account may require further elaboration. Paragraph 2 therefore enables the Competent Authorities to mutually agree the information to be exchanged and the procedures to be followed for exchanging such information and international cooperation. This could for instance take the form of bilateral or multilateral agreements or arrangements between Competent Authorities to govern the automatic exchange of filings made under, or for purposes of, the Convention, including the coordinated content of the information of the Amount A Tax Return and Common Documentation Package and timing of such exchanges, to further specify the procedures for the tax certainty and dispute resolution mechanisms, to further specify the conditions and requirements for multilateral simultaneous tax examinations, or the mode of application of the assistance in tax collection foreseen in paragraph 10.

Paragraph 3

883. Reciprocal assistance between tax administrations is feasible only if each administration is assured that the other administration will treat with proper confidence the information which it will receive in the course of their co-operation. The confidentiality rules of paragraph 3 apply to all types of information received under paragraph 1.

884. The maintenance of secrecy in the receiving Party is a matter of domestic laws. It is therefore provided in paragraph 3 that information communicated under the paragraph 1 shall be treated as secret in the receiving Party and protected in the same manner as information obtained under the domestic laws of that Party. Sanctions for the violation of such secrecy in that Party will be governed by the administrative and penal laws of that Party. In situations in which the sending Party determines that the receiving Party does not comply with its duties regarding the confidentiality of the information exchanged under this paragraph, the sending Party may suspend assistance under paragraph 1 until such time as proper assurance is given by the receiving Party that those duties will indeed be respected. This would also mean that a sending Party which is a *lead tax administration* for purposes of the tax certainty process is not required to exchange the Amount A Tax Return and Common Documentation Package with any Party that does not comply with those confidentiality duties. Parties may wish to consult the Conference of the Parties and other appropriate multilateral bodies, such as the Global Forum, with a view to informing the decision of a Party to suspend the assistance under paragraph 1.

Paragraph 4

885. Subject to paragraphs 5 and 6, the information obtained may be disclosed only to persons and authorities involved in the assessment or collection of, the enforcement or prosecution in respect of, the tax policy analysis of, or the determination of appeals in relation to the taxes imposed in accordance with Article 4 or relieved in accordance with Article 9 or taxes covered by the exchange of information provisions of a bilateral or multilateral tax treaty or agreement (including the Convention on Mutual Administrative Assistance in Tax Matters, double taxation conventions and tax information exchange agreements) in force between that Party and the Party providing the information, or the oversight of the above. This means that the information may also be communicated to the taxpayer, his proxy or to the witnesses. This also means that information can be disclosed to governmental or judicial authorities charged with deciding whether such information should be released to the taxpayer, his proxy or to the witnesses. Amount A may be administered at different levels of government, including federal, national, state, cantonal or local, in accordance with domestic law. In this respect, paragraph 4 allows the Party to disclose the information obtained to the concerned tax authorities at the relevant level of government. Information may, however, not be disclosed to state, cantonal or local tax authorities, in case such authorities, in accordance with domestic law, are not involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes imposed in accordance with Article 4 or relieved in accordance with Article 9 or taxes covered by the exchange of information provisions of a bilateral or multilateral tax treaty or agreement. Finally, the necessary information may be disclosed for the purpose of tax policy analysis, but only to relevant governmental agencies to perform their duties in this respect. The information received by a Party may be used by concerned persons or authorities only for the purposes mentioned in paragraph 4, but only insofar as the taxation for which the information is used is not contrary to the Convention or the terms of a bilateral or multilateral tax treaty or agreement in force between the Party that provided the information pursuant to paragraph 1 and the Party that has obtained the information. Furthermore, information covered by paragraph 1 should not be disclosed to persons or authorities not mentioned in paragraph 4, regardless of domestic information disclosure laws such as freedom of information or other legislation that allows greater access to governmental documents. For the avoidance of doubt, non-taxpayer specific information, including statistical data, about or generated on the basis of the information that was received by a Party through the exchange of information may be disclosed to third parties if the information does not, directly or indirectly, reveal the identity of one or more taxpayers and the sending and receiving Parties have consulted with each other and it is concluded that the disclosure and use of such information would not impair tax administration in either the sending or the receiving Party.

886. Information can also be disclosed to oversight bodies. Such oversight bodies include authorities that supervise tax administration and enforcement authorities as part of the general administration of the Government of a Party. However, if the information appears to be of value to the receiving Party for other purposes than those referred to in paragraph 4, that Party may not use the information for such other purposes, but it must resort to means specifically designed for those purposes (e.g., in case of a non-fiscal crime, to a treaty concerning judicial assistance).

887. The information obtained can be communicated to the persons and authorities mentioned and on the basis of the third sentence of paragraph 4 can be disclosed by them in court sessions held in public or in decisions which reveal the name of the taxpayer. Once information is used in public court proceedings or in court decisions and thus rendered public, it is clear that from that moment such information can be quoted from the court files or decisions for other purposes even as possible evidence. But this does not mean that the persons and authorities mentioned in paragraph 4 are allowed to provide on request additional information received.

Paragraph 5

888. In light of the multilateral nature of the Convention, as well as the determination of taxes applied, and the corresponding elimination of double taxation provided thereunder, it is essential that information exchanged under paragraph 1 for the administration and enforcement of the Convention can be made available to any other Party to the Convention in an efficient manner. This is particularly important in the context of multilateral tax certainty programs or dispute resolution mechanisms, as reflected in Articles 22 through 36 on the tax certainty process for Amount A, as these mechanisms foresee multilateral panels and discussions that can only operate efficiently if the relevant information can be shared freely between the participants in such panels and discussions.

889. Paragraph 5 therefore contains an express provision that permits any information provided by a Party to another Party under this Article to be transmitted by the latter to a third Party, provided that such onward exchange of information is foreseeably relevant for the purpose of administering or enforcing the Convention or the domestic laws concerning taxes imposed in accordance with Article 4 or relieved in accordance with Article 9. Paragraph 5 further clarifies that any transmission beyond the scope of the tax certainty or dispute resolution process is subject to the prior authorisation from the Competent Authority of the initial supplying Party. A third Party that receives information under paragraph 5 shall be subject to the confidentiality provisions of paragraph 3 and the limitations on use in paragraph 4 with respect to such information and the mechanism foreseen in paragraph 5 shall not be used to circumvent any such obligations. For example, if a (first) Party indicates in writing to the second Party that it has declined to exchange information with a third Party because of confidentiality concerns, then the second Party should not transmit such information it has received from the first Party to the third Party because this transmission would circumvent the obligation of paragraph 3. The form and scope of the prior authorisation will be specified in a mutual agreement between Competent Authorities pursuant to paragraph 2.

Paragraph 6

890. To ensure that the dispute resolution mechanisms under the Convention can accomplish their purpose without undermining the confidentiality provisions, it is important that the Competent Authorities be permitted to provide Independent Experts of the *determination panel* and Dispute Resolution Panel, as set out in Articles 27 and 28 (for the *determination panel*) and Articles 35 and 36 and Annex G (for the dispute resolution panel), with relevant information, subject to the same strict confidentiality requirements that would apply to the Competent Authorities themselves. To accomplish this, paragraph 6 provides that, solely for the purpose of administering or enforcing the Convention, Independent Experts Panel shall be considered to be persons or authorities to whom information may be disclosed.

891. Such information may also be disclosed to prospective Independent Experts, but solely to the extent necessary to verify their ability to fulfil the requirements of an Independent Expert, including, for example, their independence and impartiality. This information should therefore generally not go beyond the name of the MNE Group and the period(s) to be covered by the panel.

892. Paragraph 6 additionally provides that information received by the Competent Authorities from Independent Experts, shall be considered information exchanged pursuant to paragraph 1.

893. Paragraph 6 further clarifies that the information obtained by Independent Experts shall be treated as confidential and may only be used by them to fulfil their role, i.e. in the context of the tax certainty or dispute resolution procedure in relation to which the person acts as an Independent Expert.

894. As a practical matter for ensuring the effective implementation of paragraph 6, Competent Authorities should ensure that Independent Experts agree in writing, prior to receiving any information, to

treat the information relating to such procedure consistently with the confidentiality, nondisclosure and limitations on use requirements of paragraph 6. As part of an agreement between Competent Authorities pursuant to paragraph 2, the Competent Authorities may wish to settle the details of this process, including which Competent Authority would obtain such written agreement, as well as any appropriate and dissuasive sanctions for non-compliance with the obligations set out in paragraph 6 by Independent Experts. In general, it would be appropriate that the written agreement from the Independent Experts is obtained and governed by the laws of the *lead tax administration*, including with respect to the consequences of breaching such an agreement.

Paragraph 7

895. According to paragraph 7, Parties must use their information gathering measures, even though invoked solely to provide information to another Party and irrespective of whether the information could still be gathered or used for domestic tax purposes in the supplying Party. Thus, for instance, any restrictions on the ability of a Party to obtain information from a person for domestic tax purposes at the time of a request (for example, because of the expiration of a statute of limitations under the Party's domestic law or the prior completion of an audit) must not restrict its ability to use its information gathering measures for information exchange purposes. The term "information gathering measures" means laws and administrative or judicial procedures that enable a Party to obtain and provide the information.

896. Paragraph 7 does not oblige a Party to provide information in circumstances where it has attempted to obtain the information but finds that the information no longer exists following the expiration of a domestic record retention period. However, where the information is still available notwithstanding the expiration of such retention period, the Party cannot decline to exchange the information available. Parties should ensure that reliable accounting records are kept for five years or more.

897. The second sentence of paragraph 7 makes clear that the obligation contained in paragraph 7 is subject to the limitations of paragraph 12 but also provides that such limitations cannot be construed to form the basis for declining to supply information where a Party's laws or practices include a domestic tax interest requirement. Thus, whilst a Party cannot invoke paragraph 12 and argue that under its domestic laws or practices it only supplies information in which it has an interest for its own tax purposes, it may, for instance, decline to supply the information to the extent that the provision of the information would disclose a trade secret.

Paragraph 8

898. Paragraph 8 stipulates that a Party shall not decline to supply information solely because the information is held by a bank or other financial institution. Thus, paragraph 8 overrides paragraph 12 to the extent that paragraph 12 would otherwise permit a Party to decline to supply information on grounds of bank secrecy. Similarly, a Party shall not decline to supply information solely because the information is held by persons acting in an agency or fiduciary capacity or because it relates to an ownership interest in a person, including companies and partnerships, foundations or similar organisational structures.

899. Paragraph 8 does not preclude a Party from invoking paragraph 12 to refuse to supply information held by a bank, financial institution, a person acting in an agency or fiduciary capacity or information relating to ownership interests. However, such refusal must be based on reasons unrelated to the person's status as a bank, financial institution, agent, fiduciary or nominee, or the fact that the information relates to ownership interests. For instance, a legal representative acting for a client may be acting in an agency capacity but for any information protected as a confidential communication between attorneys, solicitors or other admitted legal representatives and their clients, paragraph 12 continues to provide a possible basis for declining to supply the information.

Paragraph 9

900. Paragraph 9 contains an explicit provision to ensure the efficient operation of tax examinations abroad under the Convention, which are foreseen as one of the methods for exchanging information under paragraph 1. In this respect, paragraph 9 provides that a Party may allow, in accordance with its domestic law, representatives of another Party to interview relevant individuals and examine books and records in the first-mentioned Party, which may for instance arise in case a tax certainty or dispute resolution process would require an on-site visit of panel members at the premises of a taxpayer. The scope of the consent and the related procedures should be further elaborated in a mutual agreement between the Competent Authorities of the Parties concerned pursuant to paragraph 2.

901. Where a Competent Authority of a Party has agreed to allow representatives of another Party to interview relevant individuals and examine books and records in the first-mentioned Party by means of a mutual agreement pursuant to paragraph 1, the first-mentioned Party may not invoke its domestic laws to impede the operation of the tax certainty and dispute resolution processes for Amount A in Articles 22 through 36 in that Party. For example, a Party that has offered to host officials of another Party may not subsequently invoke its domestic laws to impede the operation of a meeting of a *review panel* or *determination panel*, or with a review of a taxpayer's *internal control framework*.

Paragraph 10

902. Paragraph 10 provides Parties wishing to do so with the possibility to provide assistance to recover tax claims arising in application of the Convention. In this respect, paragraph 10 foresees that a Party may choose to engage in the assistance to recover tax claims in application of the Convention either with certain other Parties or with all other Parties. In order to activate the provisions of this paragraph, two steps are required. Firstly, a Party must notify its intention to provide assistance to recover tax claims in application of the Convention to the Depository, indicating with which other Parties it wishes to apply the provisions of paragraph 10. Secondly, for the provisions of paragraph 10 to apply, the other Party must also have included the first-mentioned Party in its notification regarding assistance in tax collection. As such, the assistance to recover tax claims in application of the Convention will only apply between Parties that have included each other in their respective notifications. The notifications may be modified or withdrawn, either in respect of certain or all Parties at any time and take effect on the date they are notified to the other Parties by the Depository. In case an activated relationship for the assistance to recover tax claims in application of the Convention ceases to exist as a consequence of a modification or withdrawal of a notification, the assistance foreseen by paragraph 10 may no longer be provided.

903. The remainder of paragraph 10 contains the procedural aspects for the assistance in the collection. For any aspects not covered by paragraph 1, a mutual agreement among the Competent Authorities of the Parties concerned may be concluded pursuant to paragraph 2. This could, for instance, cover arrangements on cost-sharing, currency, exchange rates and transfer of payments in relation to the assistance foreseen by paragraph 10, or the interpretation of the exception to not provide assistance in tax collection in case of clearly disproportionate administrative burdens, as foreseen in paragraph 12(e).

904. The provisions for assistance to recover tax claims are largely modelled after those of the Convention on Mutual Administrative Assistance in Tax Matters and Article 27 of the OECD Model and the UN Model. To the extent of the commonalities, the Commentaries to them can be used as interpretative guidance as a complement to this Explanatory Statement.

Paragraph 11

905. Paragraph 11 provides a Party with the possibility to permit the service of documents with respect to the taxes of another Party imposed in accordance with Article 4, directly, either through the post only or both through the post and electronically. In order to activate this provision, a Party must notify its intention to permit the service of documents directly, either through the post only or both through the post and electronically to the Depository, specifying one of the two above-mentioned approaches for the service of documents it is permitting, as well as any relevant procedural requirements (including the permissible types of documents that may be served), and listing the other Parties with respect to which it wishes to apply this provision. The notifications may be modified or withdrawn, either in respect of certain or all Parties at any time and take effect on the date they are notified to the other Parties by the Depository. In case an activated relationship ceases to exist as a consequence of a modification or withdrawal of a notification, the service of documents on this basis is no longer permitted.

906. In case a Party does not permit another Party to service documents directly, either through the post only or both through the post and electronically, paragraph 11 provides that the first-mentioned Party shall, upon request of the other Party, provide administrative assistance in the service of documents with respect to the taxes of such other Party imposed in accordance with Article 4. In such case, the first-mentioned Party is expected to notify the Depository, specifying any relevant procedural requirements for processing such requests for administrative assistance. Such requirements could for instance include the timelines for the service of documents, the required language of the documents and limitations for providing administrative assistance (e.g., to provide assistance only in respect of documents that are not related to criminal matters).

Paragraph 12

907. Paragraph 12 contains certain limitations and exceptions to the exchange of information and international cooperation under Article 37. In the first place, the paragraph contains the clarification that a Party is not bound to go beyond its or the other Party's internal laws and administrative practice in putting information at the disposal of the other Party. However, internal provisions concerning tax secrecy should not be interpreted as constituting an obstacle to the exchange of information under paragraph 1. As mentioned above, Parties are obliged to observe secrecy with regard to information received under paragraph 1.

908. In this respect, paragraph 12(a) and (b) specify that a Party does not need to go so far as to carry out administrative measures that are not permitted under the laws or practice of its Jurisdiction or those of the other Party, to carry out measures which would be contrary to public policy (*ordre public*), or to supply items of information that are not obtainable under the laws or in the normal course of administration of its Jurisdiction or those of the other Party. It follows that a Party cannot take advantage of the information system of the other Party if it is wider than its own system. Thus, a Party may refuse to provide information where the requesting Party would be precluded by law from obtaining or providing the information or where the requesting Party's administrative practices result in a lack of reciprocity.

909. In addition to the limitations referred to above, paragraph 12(c) contains a limitation concerning the disclosure of certain secret information. Secrets mentioned in this subparagraph should not be taken in too wide a sense. Before invoking this provision, a Party should carefully weigh if the interests of the taxpayer really justify its application. Otherwise, it is clear that too wide an interpretation would in many cases render ineffective the exchange of information provided for in paragraph 1. The Party in protecting the interests of its taxpayers is given a certain discretion to not proceed with the exchange of information, but if it does supply the information deliberately the taxpayer cannot allege an infraction of the rules of secrecy. In its deliberations regarding the application of secrecy rules, the Party should also take into

account the confidentiality rules of paragraph 3. The domestic laws and practices of the Party together with the obligations imposed under paragraph 4, may ensure that the information cannot be used for the types of unauthorised purposes against which the trade or other secrecy rules are intended to protect. Thus, a Party may decide to supply the information where it finds that there is no reasonable basis for assuming that a taxpayer involved may suffer any adverse consequences incompatible with information exchange.

910. In most cases of information exchange no issue of trade, business or other secret will arise. A trade or business secret is generally understood to mean facts and circumstances that are of considerable economic importance and that can be exploited practically and the unauthorised use of which may lead to serious damage (e.g., may lead to severe financial hardship). The determination, assessment or collection of taxes as such could not be considered to result in serious damage. Financial information, including books and records, does not by its nature constitute a trade, business or other secret. In certain limited cases, however, the disclosure of financial information might reveal a trade, business or other secret. For instance, information on certain purchase records may raise such an issue if the disclosure of such information revealed the proprietary formula used in the manufacture of a product.

911. Paragraph 12 also includes a limitation with regard to information which concerns the vital interests of the Party itself. To this end, it is stipulated that Parties do not have to supply information the disclosure of which would be contrary to public policy (*ordre public*). However, this limitation should only become relevant in extreme cases. For instance, such a case could arise if a tax investigation in a Party were motivated by political, racial, or religious persecution. The limitation may also be invoked where the information constitutes a state secret, for instance sensitive information held by secret services the disclosure of which would be contrary to the vital interests of the supplying Party.

912. Finally, in respect of paragraph 12(d), a market jurisdiction shall pursue all reasonable means of collection or conservancy, as the case may be, available under its laws or administrative practice before requesting assistance in the collection of *revenue claims* to the other Party. The “reasonable means” include efforts to collect *revenue claims* from *local entities* and *relief entities* which bear secondary liability under Article 17 as well as from the Designated Payment Entity which bears primary liability.

Part VI – Treatment of specific measures enacted by Parties

Section 1 – Removal and standstill of digital services taxes and relevant similar measures

Article 38 – Removal of existing measures

Paragraph 1

913. Article 38(1) compels the Parties to withdraw the measures listed in Annex A (List of Existing Measures Subject to Removal). A Party whose existing measure is listed in Annex A has the obligation not to apply the listed measures to any person starting from the first day of the next calendar year that begins on or after the expiration of a period of six months from the date on which the Convention enters into force for that Party with respect to that Party – i.e. the first day on which the Convention can enter into effect with respect to that Party.

914. The Parties are obliged not to apply existing measures to ‘any person’. The term “person” in Article 38(1) includes any individual, trust, body corporate or entity that is treated as a body corporate for tax purposes, and any other body of persons. The Parties are obliged not to apply existing measures to any person regardless of the nature or corporate status of the person, regardless of whether the person is a Covered Group or not, and regardless of whether the person is a resident in a Party or not. The date as of which a Party is obliged to remove an existing measure listed in Annex A is determined by Article 49(4).

Paragraph 2

915. Article 38(2) clarifies that listing or not listing a measure in Annex A (List of Existing Measures Subject to Removal) does not constitute evidence of whether that measure meets the definition of “digital services tax or relevant similar measure” set out in Article 39(2). This provides that the inclusion of a measure in Annex A does not indicate that that measure meets the definition of Article 39(2). Furthermore, this also provides that the absence of a measure from Annex A does not indicate that that measure does not meet the definition of Article 39(2).

916. In addition, the paragraph provides that listing or not listing a measure determines that measure’s treatment solely for purposes of the Convention, and not for any other purpose.

Article 39 – Elimination of Amount A allocations for parties imposing DSTs and relevant similar measures

Paragraph 1

917. Article 39(1) provides for the full elimination of allocating Amount A Profits with respect to the Parties that impose a measure that constitutes a “digital services tax or relevant similar measure”, as defined in paragraphs 2 and 3, or fail to withdraw an existing measure listed in Annex A. Full denial of

allocating Amount A Profits to the Party as a result of Article 39(1) should only take place if the measure imposed by the Party is in force and in effect. In other words, if the measure enacted by the Party is not yet in force or not yet in effect in a Period, there will be no full elimination of Amount A Profits. The process for the Conference of the Parties to determine that a Jurisdiction has a *digital services tax or relevant similar measure* in force and effect is described in Annex H.

918. Since Article 39 applies to all measures of a Party that are in force and effect and that meet the definition of paragraph 2, a measure that was in force at the time the Convention comes into effect but was not listed in Annex A may be subject to a review by the Conference of the Parties under the same terms as any measures enacted by a Party after the Convention comes into effect. However, it must be noted that pursuant to Annex H(10), when those measures that were already in effect at the time of the opening to signature of the Convention are found to be a *digital services tax or relevant similar measure* by the Conference of the Parties, Amount A shall be denied only for any Period starting on or after the date of the Conference's decision, and not retroactively.

919. Paragraph 1(a) ensures that the relevant Jurisdiction will not be allocated any Amount A taxing rights under the Convention. The elimination of Amount A taxing rights under this paragraph will not lead to any reallocation of Amount A taxing rights to other market jurisdictions, whose taxing rights will be unchanged. Furthermore, the share of Amount A denied to a Jurisdiction under this paragraph will be taken out of the profits considered for purposes of elimination of double taxation. A Jurisdiction for which Amount A is denied is not freed from any obligation to relieve double taxation under the Convention.

920. Additionally, paragraph 1(b) provides that the relevant Jurisdiction may not impose tax under any domestic law provisions that implement the Amount A framework in a period where the measure is in force and in effect.

921. Amount A taxing rights should be eliminated with respect to any Period, as defined under Article 2(gg), during which the measure covered by Annex A(2) is in force and in effect. Amount A allocations would remain available for any period in which no such measure was in force or in effect. Withdrawing or otherwise terminating the application of a measure that was within the scope of the definition would allow a Party to keep Amount A allocations related to Periods that begin after the withdrawal or termination of that measure. In the situation that a Jurisdiction's tax year and the applicable reporting period do not align, the elimination of Amount A Profits should be proportional to the duration of time that the measure was in effect during the relevant reporting period.

922. Article 39 does not impose any obligations on the Parties to repay any taxes collected under a measure that constitutes a "digital services tax or relevant similar measure", as defined in paragraph 2.

Paragraph 2

923. Article 39(2) contains the general definition of a "digital services tax or relevant similar measure". The three subparagraphs set out cumulative conditions, so that only a measure that satisfies all three criteria is treated as a *digital services tax or relevant similar measure*. In determining whether a measure is covered by these criteria or by one of the three exclusions defined in paragraph 3, the substance of the measure would take precedence over its formal classification or label under the enacting Party's domestic law.

Subparagraph (a)

924. Paragraph 2(a) provides the first test among the three cumulative conditions, and ensures that only taxes of which the application or amount is determined primarily on the basis of market-based criteria

such as the location of customers or users is covered by the definition. The Amount A mechanism reallocates taxing rights to market jurisdictions on the basis of a special Nexus, based on the Revenues of a Covered Group, and revenue sourcing rules (Articles 6 and 7). Amount A is intended to replace digital services taxes and relevant similar measures, which are similarly based on market-based criteria, to prevent the proliferation of uncoordinated unilateral measures and ensure the stability of the international tax framework.

925. Paragraph 2(a) provides the location of customers or users as examples of market-based criteria. This is not an exclusive list, so similar proxies such as gross revenues or sales in a market could also qualify as 'other similar market-based criteria.' In order for a measure to meet the first condition, such market-based criteria must determine either the application of tax or the amount of tax imposed.

926. For instance, if a Party applies certain measures to online advertisements provided to users located in that Jurisdiction, that measure would meet the first condition because its application is based on market-based criteria, namely the location of users. As another example, if a Party levies a measure that determines the amount of tax based on the gross revenues of online intermediary services that arise in that Party, that measure would also meet the first condition because the amount of tax imposed is determined on the basis of the market-based criteria.

927. Even if there are other auxiliary criteria with respect to determining the application or the amount of tax levied, the measure would still meet the first condition if the market-based criteria at issue are the primary criteria to determine the application of the tax or the amount of tax imposed. For instance, if the application of the measure is determined based on both market-based and other non-market-based criteria, but the amount of tax levied is calculated on the basis of a Group's sales in the concerned Jurisdiction, the measure would still meet the first condition because market-based criteria play a critical role in determining the tax amount.

Subparagraph (b)

928. Paragraph 2(b) provides the second test among the three cumulative conditions, that is the ring-fencing of the measure to non-resident or foreign-owned businesses. It addresses two different types of measures.

929. Paragraph 2(b)(i) covers measures that apply by their terms solely to businesses carried out by persons that are non-residents or foreign-owned businesses. Firstly, a person is deemed to be a resident of a Party if it is liable to tax under domestic law of that Party by reason of its domicile or similar criteria, consistent with the approach taken in Article 4(1) of the OECD Model and its Commentary and of the UN Model. A person that is resident of a Party and of another Jurisdiction would still be considered a resident of a Party for purposes of this paragraph. Secondly, a business is considered to be foreign-owned if one or more non-residents collectively have a direct or indirect ownership of it exceeding 50 per cent.

930. Paragraph 2(b)(ii) covers measures that, while applicable on their face to residents as well as non-residents, or domestic-owned businesses as well as foreign-owned businesses, nevertheless have specific design features that result in a *de facto* ring-fencing of non-residents or foreign-owned businesses.

931. To determine whether a measure falls under this subparagraph, a three-steps assessment must be conducted, which consists in determining if: (1) there is one of the legislative features mentioned by the subparagraph; (2) this legislative feature causes the measure to apply in practice exclusively or almost exclusively to non-residents or foreign-owned businesses; and (3) it has the effect of insulating domestic businesses from the application of the tax. It is only if the answer is positive at each of these steps that the measure is regarded as *de facto* ring-fenced.

Legislative features

932. This clause mentions three categories of legislative features that may result in ring-fencing: revenue thresholds, exemptions for taxpayers subject to domestic corporate income tax in that Party, and other scope restrictions.

933. Revenue thresholds would generally be considered to target non-residents or foreign-owned businesses when their implementation results in practice in the measure being applied exclusively or almost exclusively to non-residents or foreign-owned business while ensuring that residents supplying comparable goods and services are exempt from the measure. For example, a levy imposed on streaming video services supplied by residents and non-residents, but limited in its design to suppliers whose revenue exceed a threshold set at a level that is met almost exclusively by foreign-owned suppliers (because practically all domestic-owned suppliers of similar services fall below the revenue threshold), could be covered by paragraph 2(b)(ii). Common revenue thresholds aimed at exempting small enterprises or micro-enterprises, or that are already used by the Party in other areas of its tax legislation (for example, thresholds that may apply for value added tax purposes), are not intended to be covered in this regard.

934. Exemptions for taxpayers subject to domestic corporate income tax in a Party benefit non-residents only when they have a permanent establishment in that Party. Measures that provide such exemptions are therefore considered ring-fenced, unless such measures only relate to tax procedure obligations.

935. Other scope restrictions are the elements defining the material scope of application of the measure, like the definition of specific activities or specific categories of taxpayers which are subject to the tax.

Practical application

936. Clause (A) provides for a factual assessment of the characteristics of the companies in-scope of the measure, both in terms of their residence Jurisdiction and ownership structure. If all the in-scope companies are non-residents or foreign-owned businesses, then clause (A) is met. If there are some resident and domestic-owned businesses, it must be determined if their proportion is small enough for the measure to be considered as applying “almost exclusively” to non-resident or foreign-owned businesses. For example, it would be the case if only a few percent of the taxpayers were both resident and domestic-owned.

937. This assessment relies on the collection of data on the proportion of non-resident or foreign-owned taxpayers. It is on the enacting Party to provide this data, as part of the execution of the MLC in good faith. Data on the actual proportion of taxpayers shall be provided when the measure has been applied for enough time to allow so. When it is not the case, in particular when a request for early clarification has been introduced by the enacting Party under Annex H(1)(a), or when the enacting Party does not provide this data, the evaluation will be based on the available elements of impact assessment.

Insulation of domestic businesses

938. Clause (B) provides that the concerned measure needs to have the effect of insulating domestic businesses from the application of the tax. In the context of the MLC, a measure is regarded as insulating domestic businesses when it is designed in a way that prevents them from being covered.

939. Clauses (A) and (B) must be met cumulatively for a measure to be ring-fenced. This means that the mere fact that a measure only applies in practice exclusively or almost exclusively to non-resident or foreign-owned businesses is not enough to come to this conclusion. The application of clause (B) allows

to take into account elements that can explain such practical outcomes while showing the measure has not been built in order to insulate domestic businesses.

940. For the purpose of assessing a measure against clause (B), both the policy objectives of the concerned measure and the overall distribution of domestic and foreign businesses should be taken into account. Concerning the former, when the exclusive or almost exclusive application of a measure to domestic or foreign-owned businesses is the result of the pursuit of policy objectives that are not related to the insulation of domestic businesses, and the legislative features are consistent with these objectives, the measure shall not be considered as ring-fenced. The policy objectives of a measure would be reasonably concluded based on an examination of all facts and circumstances surrounding the introduction of the measure. For example, in a situation where all non-renewable energy providers are foreign-owned while domestic renewable energy providers exist, an environmental tax applying only to non-renewable energy providers should not be seen as meeting clause (B) due to the presence of an obvious policy objective unrelated to insulating domestic businesses – environmental policy.

941. Other elements may be taken into account as part of the “relevant facts and circumstances” pursuant to clause (B). Elements like its longstanding character, the fact that similar measures are common in many Jurisdictions and generally seen as permissible, the existence of domestic competitors at the time the measure was enacted or of a realistic expectation of domestic competitors in the foreseeable future suggest that the policy objective does not have the effect of insulating domestic businesses. For example, in a situation where all telecommunication providers are foreign-owned, a tax applying to the telecommunication sector could not be seen as meeting clause (B) due to the long-standing character of the tax, its consistency with similar measures enacted in other Jurisdictions, and the particular distribution of domestic and foreign businesses in the Party. Conversely, elements like the fact that the Jurisdiction has enacted similar measures with respect to other industries or segments in which there are no domestic competitors or that the measure is revised or withdrawn either when the potential for domestic competitors becomes more likely or when domestic competitors actually appear suggest that the measure has the effect of insulating domestic businesses.

942. Clause (B) is of particular relevance when the enacting Jurisdiction has no or few resident and domestic-owned businesses in the relevant market (i.e. the market where businesses providing comparable goods or services operate) since in this case, clause (A) would be automatically satisfied. This is why the definition provides that this mere fact is not dispositive and requires all relevant facts and circumstances to be considered. In this context, the overall distribution of domestic and foreign businesses in that Party becomes a key indicator when assessing whether the legislative feature has the effect of insulating domestic businesses. For smaller economies, the majority or even all of the large enterprises could be foreign-owned. In that context, the rationale of a tax measure that applies solely to those large enterprises may have nothing to do with the result of that measure in practice, being that only foreign-owned businesses would be affected by the measure.

Subparagraph (c)

943. Paragraph 2(c) provides the third test among the three cumulative conditions, ensuring that the definition of “digital services tax or relevant similar measure” applies only to measures that are treated by that Party as outside the scope of their existing tax treaties. This rule ensures, for example, that a withholding tax that is treated as an income tax, and therefore as a covered tax for tax treaty purposes, falls outside the scope of the definition of “digital services tax or relevant similar measure”.

944. It should be emphasised that Parties are still able to impose income taxes that are market-based and ringfenced under their domestic laws if they are subject to the Party’s tax treaties. The rationale behind this third test is that income taxes that are covered by a Party’s tax treaties would be governed by the

relevant bilateral treaty provisions, where double taxation is removed based on either exemption or credit methods to relieve double taxation (Article 23A or 23B of the OECD Model or Article 23A or 23B of the UN Model). This is without prejudice to the specific treatment of some of these measures under Article 40.

945. By mentioning a measure that “is treated by that Party as outside the scope of any agreements”, the paragraph means a measure that is treated as not in-scope under at least one of the agreements the Party has committed to. When assessing whether a measure is treated as outside the scope of tax treaties, the economic and legal substance of such measures should have precedence over the labelling of such taxes.

Paragraph 3

946. Article 39(3) contains three categories of measures that are excluded from the definition of “digital services tax or relevant similar measure”. These three categories are: rules addressing artificial structuring to avoid traditional permanent establishment or similar domestic law nexus requirements based on physical presence; value added taxes, goods and services taxes, sales taxes, or other similar taxes on consumption; and generally applicable taxes imposed with respect to transactions on a per-unit or per-transaction basis rather than on an ad valorem basis.

947. In case a measure is brought to the Conference of the Parties, the applicability of exclusions will be reviewed alongside the assessment of the conditions defined in paragraph 2.

Subparagraph (a)

948. Paragraph 3(a) contains an exclusion for a limited class of rules aimed at addressing avoidance of existing domestic nexus standards based on physical presence. The exclusion covers both nexus requirements based on the direct physical presence of an enterprise and nexus requirements based on the physical presence and activity of an agent.

949. For instance, Parties may have rules addressing commissionaire arrangements that are put in place by foreign enterprises seeking to avoid permanent establishment status in that Party, or rules that ensure that a cohesive operating business in the Party is taxed as a permanent establishment despite the business’s fragmentation into several small operations. Such measures are not covered by the term “digital services tax or relevant similar measure”, because these rules result in the application of income taxes that are in scope of double taxation agreements and may therefore already fall outside the definition pursuant to paragraph 2(c). The same is true of other measures addressing artificial structuring to avoid traditional permanent establishment treatment in a Party that is based on physical presence (whether directly or through the actions of an agent), and which result in a deemed permanent establishment for income tax purposes.

950. Paragraph 3(a) would also cover other domestic rules (including separate levies directed at enforcing existing nexus standards) targeting arrangements or transactions that have as one of their principal purposes the avoidance of nexus requirements based on physical presence and for which inapplicability of the relevant nexus provisions would be contrary to their object and purpose. As such rules take the physical presence of an enterprise as a starting point for taxation and only target avoidance arrangements, these rules are not intended to be covered by the obligation not to enact digital services taxes or relevant similar measures, because they give rise to income taxes and adjustments will be made to the taxing Jurisdiction’s Elimination Profit (or Loss) under Annex B Section 4.

Subparagraph (b)

951. Paragraph 3(b) contains an exclusion for value added taxes, goods and services taxes, and sales taxes, as well as other similar taxes on consumption.

952. General taxes on goods and services are commonly designed as value added taxes, which are charged on value added - usually allowing immediate deduction of taxes on purchases by all parties but the final consumer - and are levied at multiple stages. Other Jurisdictions instead classify their general consumption taxes as a goods and services tax or a sales tax; these taxes may be levied at multiple stages or at one stage only.

953. The inclusion of other similar taxes on consumption intends to ensure that consumption taxes that are not classified as value added taxes, goods and services taxes or sales taxes, but have economic characteristics akin to the beforementioned taxes, are similarly excluded from the definition of "digital services tax or relevant similar measure". Long-standing measures, like excises on tobacco, alcoholic drinks, energy or sugar, customs and other import duties, taxes on the use of utilities (e.g. landfill taxes) or user taxes on motor vehicles, are thus expected to be covered by the exclusion.

Subparagraph (c)

954. Paragraph 3(c) constitutes an exclusion of the term "digital services tax or relevant similar measure" for generally applicable taxes imposed with respect to transactions on a per-unit or per-transaction basis rather than on an ad valorem basis. The exclusion covers transaction taxes that do not vary based on the value of the property or transaction that is the subject of the tax. In many cases, taxes that are covered by this exclusion will also be covered by paragraph 3(b).

Paragraph 4

955. Article 39(4) provides that a Party shall be considered to have a *digital services tax or relevant similar measure* in force and in effect for a Period if two conditions are met. First, it must be determined under Annex H that the Party has adopted a measure described in Article 39(2) with effect for that Period. Second, it must be the case that the Conference of the Parties has not determined that the Party has withdrawn that measure or otherwise terminated its application with respect to all companies, with effect for that Period.

Paragraph 5

956. Article 39(5) provides that the definition of "digital services tax or relevant similar measure" set out in Article 39(2) and any determination under Annex H shall be considered relevant, including as evidence, solely for purposes of the Convention and not for any other purpose.

Section 2 – Treatment of specific measures in scope of tax treaties

Article 40 – Treatment of specific measures in scope of tax treaties

957. Unlike measures covered by Part VI Section 1, the measures covered by Section 2 are not digital services taxes or relevant similar measures as defined in Article 39(2), and are therefore not subject to a withdrawal or standstill commitment. Instead, these measures, which are in scope of tax treaties, are

intended to apply tax in the enacting Jurisdiction based on interaction by the Group Entity or Covered Group with the economy of that Jurisdiction, without requiring any physical presence. To address the overlap between the intent of these measures and the intent of Amount A, Article 40 generally prevents Parties from applying such measures to a Group Entity of a Covered Group.

958. Article 40(1) provides that a Party shall not apply the measures it defines to a Group Entity of a Covered Group. A measure is subject to Article 40 when it meets two cumulative conditions:

- The first condition, under subparagraph (a), is that the measure must not be a *digital services tax or relevant similar measure* solely because it is within the scope of the enacting Jurisdiction's agreements for the avoidance of double taxation (i.e., it does not meet the condition described in Article 39(2)(c)). This means that Article 40 would not apply to a measure unless it meets the conditions described in Article 39(2)(a) and (b), i.e. it is market-based and ring-fenced towards non-resident or foreign-owned businesses. Moreover, Article 40 will not apply to any measure that is covered by any of the exclusions defined by Article 39(3).
- The second condition, under subparagraph (b), is that the threshold for applying the measure must be based on the economic activity of the Group Entity or the Covered Group in the Party, using criteria such as local sales, number of users or targeting of a domestic audience. To be within the scope of subparagraph (b), application of the measure must not require the physical presence of either the Group Entity or the payor of a payment (whether directly or through the actions of an agent). Thus, for example, withholding taxes that apply to payments made by residents of a Party (or effectively connected with a Taxable Presence in the Party that is based on physical presence), including withholding taxes on dividends, interests, royalties or technical fees, would not meet this condition and are not covered by Article 40.

959. Regardless of whether the conditions of paragraph 1 are met, paragraph 2 excludes from the application of Article 40 measures that are permitted under an agreement in effect between the Party and the Jurisdiction of residence of the Group Entity for the avoidance of double taxation with respect to taxes on income. For avoidance of doubt, nothing in paragraph 2 is intended to limit the ability of Parties to impose withholding taxes on non-residents under their domestic law.

960. When a measure meets the conditions of Article 40, the Convention prevents the Party to apply it to Group Entities of Covered Groups. This implies that no profit of these entities shall be imposed under the measure and, hence, that it will not be included in the Elimination Profit (or Loss) of Amount A.

961. The decision-making process described in Annex H does not apply to determine whether a measure meets the conditions of Article 40. Similar to the provisions of an agreement for the avoidance of double taxation, companies which claim the benefits of these provisions may use the administrative and judicial procedures that are applicable in a Party.

Part VII – Final provisions

Article 41 – Signature and ratification, acceptance or approval

Paragraph 1

962. Paragraph 1 provides that the Convention will be open for signature as of [date].

963. It goes on to provide that the Convention is open for signature by all States.

Paragraph 2

964. Paragraph 2 provides that signature of the Convention shall be followed by ratification, acceptance or approval. The appropriate term will depend on domestic legal requirements. Once the domestic procedures have been completed, an instrument of ratification, acceptance or approval will be deposited with the Depository. This is the event that triggers the rules for the entry into force of the Convention pursuant to Article 48.

Article 42 – Territorial application

Paragraph 1

965. Article 42 enables a State to extend territorial coverage of the Convention to a jurisdiction or territory for whose international relations it is responsible. It is similar in this regard to the provisions of Article 30 of the OECD Model and Article 29(2) of the BEPS Multilateral Instrument. It is of particular relevance for jurisdictions or territories which are usually not covered by the tax agreements concluded by the States responsible for their international relations. Paragraph 1 provides that this territorial extension can be done through a declaration deposited at the time of signature, when depositing its instrument of ratification, acceptance or approval, or at any later date.

966. Paragraph 1 further clarifies that the Convention shall enter into force for that jurisdiction or territory on the later of the date of entry into force of the Convention for the State and the first day of the calendar month following the expiration of a period of three months beginning on the date of the deposit of the declaration. As per Article 49(1), the Convention will enter into effect in this Jurisdiction with respect to any Period of a Covered Group beginning on or after the first day of the next calendar year that begins on or after the expiration of a period of six months from the date of entry into force described in the previous sentence.

967. A State may also choose, consistent with its usual treaty practice, to deposit a declaration at the time of signing, or when depositing its instrument of ratification, acceptance or approval, to specify that the Convention does not apply to a jurisdiction or territory for whose international relations it is responsible.

Paragraphs 2 through 7

968. Paragraphs 2 through 7 specify how the Convention applies with respect to jurisdictions or territories covered by means of a declaration described in paragraph 1.

969. Although only States are Parties to the Convention, for the purpose of applying a number of specific provisions, a jurisdiction or territory that is covered by such a declaration is treated as though it were a Party separate from the State responsible for its international relations and from any other jurisdiction or territory for whose international relations the same State is responsible. These provisions, which are listed in paragraph 2, are as follows:

- a) Article 2(l) and the provisions contained in Annex B Section 3, relating to the definition of the Designated Payment Entity. The Designated Payment Entity may be a resident of a jurisdiction or territory covered by means of a declaration under paragraph 1, either when it is the Ultimate Parent Entity of the Covered Group or the entity designated under the provisions contained in Annex B Section 3. Consequently, the tax administration of the jurisdiction or territory so covered is the *lead tax administration* in such an instance, unless the provisions of Article 32(q)(ii) through (v) are applied;
- b) Article 4, relating to the taxation of Amount A by a Party in which the Covered Group has nexus under Article 8. A jurisdiction or territory covered by means of a declaration under paragraph 1 is allocated a portion of Amount A profit under Article 5, and may impose taxation on the Designated Payment Entity with respect to this portion;
- c) Article 6(2), relating to the requirement imposed by Parties on Group Entities of a Covered Group to apply a reliable method to determine the sources of all Adjusted Revenues of the Covered Group;
- d) Article 9, relating to the obligation on Parties to provide relief when they are identified as *relieving jurisdictions*. A jurisdiction or territory covered by means of a declaration under paragraph 1 which is identified as such has relieving obligations which are separate from the obligations of the State which is responsible for its international relations;
- e) Article 11(15), relating to the allocation of the obligation to eliminate double taxation in case there is a *prior unallocated Amount A relief amount*. A jurisdiction or territory covered by means of a declaration under paragraph 1 with respect to which the Convention was not in force in the preceding Period is treated as Party separate from the State which is responsible for its international relations under these provisions;
- f) Article 12, relating to the provision of relief from double taxation by a Party. A jurisdiction or territory covered by means of a declaration under paragraph 1 which is identified as *relieving jurisdiction* has to provide relief under its own domestic law, subject to the guardrails provided in Articles 12 and 13;
- g) Article 13, relating to the identification of *relief entities*. This identification is to be conducted separately in a jurisdiction or territory covered by means of a declaration under paragraph 1 which is identified as *relieving jurisdiction*;
- h) Part V Section 1, relating to the Administration of Amount A. A jurisdiction or territory covered by means of a declaration under paragraph 1 is treated as a Party separate from the State which is responsible for its international relations with respect to the Administration of Amount A;
- i) Part V Section 2 and Annex F, relating to Tax Certainty for Amount A. A jurisdiction or territory covered by means of a declaration under paragraph 1 is treated as a Party separate from the State which is responsible for its international relations for the application of these rules, which

means in particular that it is treated as *affected party* or *listed party* as relevant. However, with respect to the provisions of Article 25, regarding the composition of *scope review panels* and *review panels*, and of Article 28 and Annex F, regarding the composition of *determination panels*, only *specified non-State jurisdictions* are treated as Parties separate from the States which are responsible for their international relations; this means in practice only those non-State jurisdictions can apply to and be represented in these panels;

- j) Article 37, relating to exchange of information and international cooperation. A jurisdiction or territory covered by means of a declaration under paragraph 1 is treated as a Party separate from the State which is responsible for its international relations in this regard, which means in particular it may receive and share information that is foreseeably relevant for the application of Amount A, under the conditions defined by Article 37.
- k) Article 49, relating to Entry into Effect. Paragraph 1 provides a rule for determining the date of entry into force of the Convention for a jurisdiction or territory covered by means of a declaration under paragraph 1, which may be different from the date of entry into force for the State responsible for its international relations. Including Article 49 in this list ensures that the entry into effect for such a jurisdiction or territory will follow the applicable date of entry into force.
- l) Annex B Section 4(13)(i)(i) relating to the determination of the tax rate used in the definition of the *withholding tax downward amount*. The tax rate used with respect to the *withholding tax downward amount* of a jurisdiction or territory covered by means of a declaration under paragraph 1 will be the rate of the income tax regime generally applicable in that jurisdiction or territory;
- m) Annex C Section 1(9) relating to the delineation of a Covered Group and the identification of its Ultimate Parent Entity in case of a *stapled structure* or a *dual-listed arrangement*. The Ultimate Parent Entity determined under these provisions may be resident in a jurisdiction or territory covered by means of a declaration under paragraph 1.
- n) Annex E relating to the supplementary provisions for the Administration of Amount A.
- o) Part VI and the provisions contained in Annex H relating to the removal and standstill of *digital services taxes or relevant similar measures* and the related review process, as well as the treatment of other specific measures in scope of tax treaties. A jurisdiction or territory covered by means of a declaration under paragraph 1 is bound by the removal and standstill commitments and in case the Conference of the Parties determines that a measure enacted by such jurisdiction or territory is a *digital services tax or relevant similar measure*, it shall not be allocated any Amount A profit under Article 5 and shall not impose taxation on Amount A Profit, while there would be no consequences for the State which is responsible for its international relations. Reciprocally, if the Conference of the Parties determines a State responsible for the international relations of a jurisdiction or territory covered by means of a declaration under paragraph 1 has enacted a *digital services tax or relevant similar measure*, there will be no consequences for such jurisdiction or territory.

970. Paragraph 3 allows a jurisdiction or territory covered by a declaration under paragraph 1 to represent itself in the review process when a request is brought to the Conference of the Parties with respect to a measure it has enacted. This entails the performance of the self-assessment described in Annex H(4) and, in case an ad hoc advisory panel is formed under Annex H(8), taking the role of enacting Party. In the latter case, the Party responsible for its international relations will not be included in the panel.

However, the self-representation is conditional on a specific mention to this effect in the declaration described in paragraph 1. Absent such a specific mention in the declaration, the Party responsible for the international relations of the jurisdiction or territory will perform the self-assessment and sit as the enacting Party in an ad hoc advisory panel. This specific mention is distinct from the declaration described in paragraph 8 for purposes of *specified non-State jurisdiction*.

971. Paragraph 4(a) clarifies that because the Conference of the Parties is established only among the Parties, a jurisdiction or territory covered by means of a declaration under paragraph 1 will not participate separately in the Conference of the Parties from the Party responsible for its international relations. However, paragraph 4(b) provides that solely with respect to enumerated topics related to the interpretation or implementation of Part V, *specified non-State jurisdictions* will be able to participate separately in the Conference of the Parties, and will have decision-making rights. These topics consist of the functions described in Article 47(3)(b) through (k) and (o), and addressing any additional questions that may arise as to the interpretation or implementation of the Part V, i.e. Administration and Tax Certainty.

972. Paragraphs 5 and 6 determine how to account for points allocated to a jurisdiction or territory for whose international relations a State is responsible under Annex I or the updates decided by the Conference of the Parties pursuant to Article 47(4). When determining whether the thresholds defined by the Convention for its entry into force, the lowering of the adjusted revenues threshold and its termination are met, any points allocated to such a jurisdiction which is covered by a declaration described in paragraph 1 shall be considered together with the points allocated to the Party (or in the case of Entry into Force, the Contracting State) responsible for its international relations.

973. Paragraph 7 deals with the definition of *specified non-State jurisdictions*. Subparagraph (a) provides that Guernsey, the Isle of Man and Jersey shall be treated as *specified non-State jurisdictions*, assuming they are each the subject of a declaration described in paragraph 1. Subparagraph (b) defines the conditions under which other Jurisdictions may be regarded as *specified non-State jurisdictions* after the Convention is in force, which are two-fold. First, the Party responsible for the Jurisdiction's international relations must submit a notification to this effect, certifying that the Jurisdictions meets three cumulative criteria: an independent tax system, including the competence to legislate on corporate tax on its own authority; an independent tax administration; an independent competent authority with capability and experience in international tax coordination. To assess the last criterion, Parties may refer in particular to the experience of the Jurisdiction in mutual agreement procedures and exchange of information in the context of tax agreements. Second, a discussion must take place in the Conference of the Parties, with the procedure to be determined by the Conference. A jurisdiction or territory covered by means of a declaration under paragraph 1 shall be treated as a *specified non-State jurisdiction* if following this discussion, no objection from another Party is received. In case a Party objects to a non-State jurisdiction being treated as a *specified non-State jurisdiction*, another notification may be submitted by the State responsible for its foreign relations at a later date, to which the process described above would apply.

974. A Party may withdraw its notification under subparagraph (b) of this paragraph, leading the territory or jurisdiction not to be treated any more as a *specified non-State jurisdiction*.

Article 43 – Review process to lower the adjusted revenues threshold

975. Article 43 provides a procedure for carrying out the review process leading to the lowering of the Adjusted Revenues threshold pursuant to Article 3(9) after the expiration of a period of 7 years following entry into force of the Convention.

Paragraph 1

976. Paragraph 1 specifies that Article 3(9) applies with respect to any Period beginning on or after the expiration of a period of one year from the date on which the implementation of the Convention has been deemed successful on the basis of the “implementation review” conducted in accordance with paragraphs 2 and 3. It determines the date on which the lower Adjusted Revenues threshold of EUR 10 million takes effect, by reference to the date on which the implementation of the Convention has been deemed successful. This is the date of the expiration of the period for objections set out in paragraph 5 or 6, as applicable. For example, if the implementation of the Convention is deemed to be successful on 1st of October of a given year, the expanded scope would apply to any Period beginning on or after the 1st of October of the following year.

Paragraph 2

977. Paragraph 2 provides that the implementation review shall be undertaken by the Conference of the Parties after the expiration of a period of seven years from the date of entry into force of the Convention in accordance with Article 48(1) and be completed no more than eight years from this date. The implementation review must therefore be completed, at the latest, within one year from the date on which it is required to start (noting that it may also be completed within a shorter time). For example, if the Convention enters into force on 1 July of Year 0, the review must start on 1 July of Year 7 and must be completed before 1 July of Year 8.

Paragraph 3

978. Paragraph 3 specifies that the implementation review will include consideration of whether the implementation of the Convention has been successful with respect to the elements defined in subparagraphs (a), (b), (c) and (d).

979. Subparagraph (a) relates to the rules on the elimination of double taxation in Part IV. There is “timely” double tax relief when it is provided in accordance with the relevant timeline and modalities set out under Article 12(5). That is, within 90 days of the Party receiving a valid claim for relief when relief is provided in the fiscal year of the relief entity that includes the last day of the Period of the Covered Group for which the tax liability of the Designated Payment Entity is calculated, or by way of a reduction of the earliest payments the relief entity would be required to make in respect of the instalment or interim tax filing during the fiscal year when relief is provided in the fiscal year that includes the date that is 18 months after the end of the Period (which is the fiscal year during which tax liabilities imposed on Amount A Profit are to be paid). There is “effective” double tax relief when it is compliant with the guardrails set in Articles 12 and 13, in particular, on the limitations to relief under Article 12(3) and (4) and the identification of relief entities under Article 13(1) through (5).

980. Subparagraph (b) relates to the rules on the administration of Amount A and the exchange of information. For purposes of this provision, there is “timely” payment of tax liabilities when the payment is compliant with the 18-month deadline set by Article 16 (where streamlined compliance applies) or when

the rules on secondary liability defined by Article 17 have been applied effectively. Failure of a Covered Group to make timely payment of liabilities would not, in and of itself, lead to the conclusion that implementation of the MLC is not successful, since payment of liabilities is within the control of Covered Groups, not Parties to the Convention. However, consideration would be given to whether the operation of procedures related to Amount A are working in a way to make it feasible for a Group wishing to make timely payment to do so. The “timely and effective exchange of information” refers to the provisions of Article 37 and any other provisions in the MLC that require a Party to exchange documents with other Parties. It also applies with respect to maintaining information secrecy. The last item of subparagraph (b), regarding “the resources required to administer this Convention, relative to the Amount A Profit reallocated under this Convention”, means that the compliance burden related to the operation of Amount A (in particular on behalf of Parties, including Parties that are *relieving jurisdictions* and those where Ultimate Parent Entities are located) should not be disproportionate to the fiscal revenues generated by the reallocation of taxing rights.

981. Subparagraph (c) relates to the timeliness and effectiveness of the procedures of Tax Certainty for Amount A and Tax Certainty for Issues Related to Amount A. Regarding Tax Certainty for Amount A, the assessment should focus on the ability to form the panels in a timely manner, respect for the deadlines set in Part V Section 2 and Annex F, and the effective application of tax *certainty outcomes*. Regarding Tax Certainty for Issues Related to Amount A, the assessment should focus on the ability to form panels in a timely manner and whether the timelines under Article 35, Article 36 and Annex G of the Convention have been followed.

982. Subparagraph (d) relates to the removal and standstill of *digital services taxes or relevant similar measures*. Consideration should be given to the effective removal of measures listed in Annex A, to the compliance with the deadlines set by Annex H for the decision-making process in the Conference of the Parties and to the effective elimination of the allocation of Amount A Profit in case the Conference of the Parties decides that a measure meets the definition set by Article 39.

983. As part of the implementation review, the intent of the negotiators is that a public consultation be held, with modalities to be defined by the Conference of the Parties. The purpose of this public consultation would be to inform the implementation review, with the Conference of the Parties defining how the input collected would inform the implementation review.

Paragraph 4

984. Paragraph 4 provides that the Conference of the Parties may agree on a process for collecting information from the Parties on an ongoing basis with respect to their experience in implementing the Convention. Meetings of the Conference of the Parties shall be convened as necessary to discuss difficulties with respect to implementation and appropriate ways to address them to the extent possible before the start of the implementation review. Jurisdictions to which the Convention applies pursuant to a declaration described in Article 42(1) may take part in these discussions, as part of the delegation of the State responsible for their foreign relations or separately when they have the status of *specified non-State jurisdictions*.

985. Acting in this capacity, the Conference of the Parties may develop any guidelines setting out the modalities of assessment of successful implementation pursuant to paragraph 3.

Paragraph 5

986. Paragraph 5 provides that, as of the date that is three months after the date of completion of the implementation review (as described in paragraph 2), the implementation of the Convention shall be

deemed successful unless written objections are received before that date from either a simple majority of Parties or 20 or more Parties representing a total of 600 points or more as set out in Annex I or in the most recently updated assignment of points pursuant to Article 47(4). For example, if the implementation review is completed on 1 July of Year 8, the date mentioned in paragraph 5 will be 1 October of Year 8. Written objections are to be accompanied by an explanation in sufficient detail, identifying the elements listed under paragraph 3 with respect to which a Party considers implementation to be unsuccessful.

Paragraph 6

987. Paragraph 6 provides that, if written objections have prevented implementation from being deemed successful, a meeting of the Conference of the Parties shall be convened to address the implementation issues identified in the written objections. The Conference of the Parties may discuss any appropriate ways to solve the implementation issues. As a default rule, the Convention sets a period after which the implementation of the Convention is deemed successful (meaning that the revenue threshold will be lowered) unless a certain number of Parties, as specified by the paragraph, object.

988. Specifically, the paragraph provides that, following the expiration of a period of two years after the deadline described in paragraph 3 (or an alternative deadline agreed by the Conference of the Parties), the implementation of the Convention shall be deemed successful unless written objections are received before that date from either a simple majority of Parties or 25 Parties or more that together represent a total of 700 points or more, as set out in Annex I or in the most recently updated assignment of points pursuant to Article 47(4). For example, if the deadline described in paragraph 5 is 1 October of Year 8, the implementation of the Convention shall be deemed successful pursuant to paragraph 6 on 1 October of Year 10, unless an alternative date is agreed by the Conference of the Parties (and unless the required number of written objections is received before that date). The written objections must identify which of the specific implementation issues identified in previous written objections have not yet been addressed.

Paragraph 7

989. If written objections prevent implementation from being deemed successful at the date that is two years after the deadline set out in paragraph 5 or other date that may be agreed by the Conference of the Parties under paragraph 6, paragraph 7 provides for automatic termination of the Convention unless the Parties decide by simple majority within three months after the deadline described in paragraph 6 that the Convention shall not terminate. For example, if the deadline described in paragraph 6 is 1 October of Year 10, the date described in paragraph 7 will be 1 January of Year 11. If the Parties decide not to terminate the Convention, they will be bound by the Convention based on the definition of a Covered Group described in Article 3, namely with reference to the Adjusted Revenues threshold of EUR 20 billion.

Article 44 – Amendment

Paragraph 1

990. Paragraph 1 provides that any Party can propose an amendment to the Convention by submitting the proposed amendment to the Depositary. Thereafter, the Depositary will inform the Parties and Signatories of such proposed amendment.

Paragraph 2

991. Paragraph 2 provides that, if there is support by one-third of the Parties, a meeting of the Conference of the Parties shall be convened to consider the proposed amendment within six months of the communication by the Depositary of the proposed amendment under paragraph 1.

992. Any amendment shall be adopted by *consensus* of the Parties, or by such other means as the Parties may determine by *consensus*. The entry into force of any amendment will be subject to completion of any relevant domestic procedures of each Party. At the time of adoption of the amendment, the Parties will determine the conditions for its entry into force.

Article 45 – Reservations

993. Article 45 provides that no reservations are authorised under the Convention.

Article 46 – Relationship between this Convention and Existing Tax Agreements

994. Article 46 provides that the Convention will prevail over Existing Tax Agreements to the extent of any conflict. It is not intended that the Convention freeze in time any provisions of those existing tax agreements and the Parties will be free to modify them in the future.

Article 47 – Conference of the Parties**Paragraph 1**

995. Paragraph 1 provides that a Conference of the Parties shall be established under the Convention in order to take any decisions or exercise any functions as required or appropriate under its provisions.

Paragraph 2

996. Paragraph 2 provides that the first meeting of the Conference of the Parties will be convened by the Depositary no later than three calendar months following entry into force of the Convention.

Paragraph 3

997. Paragraph 3 specifies the functions of the Conference of the Parties. These include addressing questions of interpretation or implementation of the Convention as well as specific functions set out in other provisions of the Convention which are listed under paragraph 3. In line with this paragraph, the Conference of the Parties will be able to issue interpretative guidance on the application of the Convention.

Paragraph 4

998. Paragraph 4 provides that, in addition to the functions identified in paragraph 3, the Conference of the Parties shall update the points assigned to Jurisdictions for purposes of Articles 43, 48 and 51, expressed as points out of one thousand, in lieu of the points assigned in Annex I. This update shall be based on the data available regarding the proportion of Ultimate Parent Entities of Covered Groups located

in each Party relative to the total number of Covered Groups. It is expected the Conference of the Parties will base the revision on the latest available data on the number of Covered Groups and apply the definitions of Ultimate Parent Entities and of the location of entities as per Article 2(II) and paragraph 5(a) of Annex B Section 4 to determine the points attributable to each Party. *Lead tax administrations* will be invited to provide the number of Covered Groups in their Jurisdiction as part of this process, with this data supplemented as needed with data from MNE financial statements, and other publicly available information.

999. As of the date of the update undertaken by the Conference of the Parties in the instances specified under subparagraphs (a) through (c), Annex I will cease to apply for purposes of Articles 43, 48 and 51 and the updated points as decided by the Conference of the Parties will start to apply.

1000. Subparagraphs (a) through (c) clarify the instances in which this update of the points assigned shall be undertaken. Under subparagraph a), this shall be done for the purpose of determining whether the implementation of Amount A is deemed successful under Article 43(5) and (6). Once the updated points are agreed, they shall be used for the purpose of applying Article 51(2), until a new updated list has been approved under subparagraph (b). Under subparagraph (b), this shall be done at least one year after the date on which the implementation of the Convention has been deemed successful under Article 43(5) or (6), for the purpose of applying Article 51(2). Subparagraph (c) clarifies that the update of the points assigned to Jurisdictions shall be done every five years after the date specified in subparagraph (b).

Paragraph 5

1001. Paragraph 5 provides that except where another decision-making process is provided under the Convention, or the Conference of the Parties agrees via *consensus* to adopt a different rule, decisions of the Conference of the Parties are made by *consensus* (i.e. absence of objection to a proposed decision).

Paragraph 6

1002. Paragraph 6 provides that the Conference of the Parties shall adopt its rules of procedure following entry into force of the Convention. These rules of procedure will address matters not expressly provided for under the Convention related to the functioning of the Conference of the Parties.

Paragraph 7

1003. Paragraph 7 provides that a Conference of the Parties shall be served by a dedicated Secretariat based in the OECD. This Secretariat will act under the substantive oversight of the Conference of the Parties to support the interpretation, implementation and application of the Convention. It will do so by preparing discussions and decisions of the Conference of the Parties and undertaking any other tasks assigned to it by the Conference of the Parties or pursuant to the provisions of the Convention. In line with the existing OECD legal framework, this Secretariat would be open to the recruitment of nationals of all Members of the Inclusive Framework on BEPS.

Article 48 – Entry into force

Paragraph 1

1004. Paragraph 1 provides that the Convention will enter into force on the date to be decided by the Contracting Jurisdictions pursuant to paragraph 2, after two conditions set out in subparagraphs a) and b)

are met, namely: (1) the deposit of the thirtieth instrument of ratification, acceptance or approval; and (2) the deposit of instruments of ratification, acceptance or approval by Contracting States representing a total of 600 points or more as set out in Annex I.

Paragraph 2

1005. Paragraph 2 clarifies that the Contracting States will be invited by the Depositary to decide whether and when to bring the Convention into force within three months after the conditions under paragraph 1 are met. A decision by the Contracting States to bring the Convention into force will take into account the level of participation of Contracting States expected to have obligations to relieve double taxation, as well as the goal of ensuring that the Contracting States are geographically diverse and account for approximately 60 percent or more of worldwide gross domestic product. Unlike the thresholds set in paragraph 1, the reference to this threshold of worldwide gross domestic product is intended only as guidance for the Conference of the Parties to take its decision on entry into force and is not a required condition for entry into force. Paragraph 2 further provides that such a decision shall be adopted only if supported by a simple majority of Contracting States at the time the meeting of the Contracting States is convened as well as by Contracting States representing a total of 600 points, based on the points assigned to each Contracting Jurisdiction under Annex I.

Paragraph 3

1006. Paragraph 3 clarifies that if a decision to bring the Convention into force is not reached at the meeting convened under paragraph 2, the Contracting States will be invited by the Depositary to meet every six months – or a longer period if decided by the Contracting States – until such a decision is reached.

Paragraph 4

1007. Paragraph 4 provides that in the case of a Signatory ratifying, accepting or approving the Convention after the decision on the date of entry into force has been made in accordance with paragraph 1, the Convention shall enter into force for that Signatory on the later of the date of entry into force of the Convention determined under paragraph 1 and the first day of the calendar month following the expiration of a period of three months beginning on the date of the deposit by such Signatory of its instrument of ratification, acceptance or approval. As of this date, such Signatory will become a Party and will be bound by the Convention. For example, if the Convention enters into force pursuant to paragraph 1 on 1 January of Year 1, and a Signatory deposits its instrument of ratification, acceptance or approval on 1 March of Year 2, the Convention will enter into force for that Signatory on 1 July of Year 2.

Article 49 – Entry into effect

1008. The purpose of Article 49 is to provide the date of entry into effect of the Convention.

Paragraph 1

1009. Paragraph 1 defines the default date of entry into effect of the Convention for a Covered Group. Unless the Covered Group is subject to paragraph 2, the first Period for which the Convention will apply to it will be its first Period beginning on or after this date. This means that the earliest date that the Convention can enter into effect in a Party is the first day of the next calendar year following the date which is six months after the date on which the Convention enters into force for that Party. For example, if the Convention enters into force for a Party in March 2025, the first day of the next calendar year following the

date which is six months after that date is 1 January 2026. Where a Covered Group's first Period that begins or after 1 January 2026 is the Period 1 April 2026 to 31 March 2027, the Convention will have effect for this Covered Group in that Party for the Period 1 April 2026 to 31 March 2027 and subsequent periods.

Paragraph 2

1010. Paragraph 2 provides that where at least one of the Group Entities of a Covered Group has been subject to at least one of the measures listed in Annex A in the calendar year immediately prior to the calendar year described in paragraph 1, the Convention enters into effect in a Party with respect to that Covered Group on the first day of the calendar year described in paragraph 1 (the "date of entry into effect" for purposes of paragraphs 2 through 4).

1011. This provision is meant to ensure that for the concerned Covered Groups, the entry into effect of Amount A aligns with the entry into effect of the digital services tax withdrawal commitment as per paragraph 4. It results in the concerned Covered Group applying Amount A from the 1st of January of that calendar year to the day before the beginning of its next Period, with specific provisions of paragraph 3 dealing with this situation.

1012. The information on whether a Covered Group has Group Entities subject to a listed measure will be provided through the Amount A Tax Return and Common Documentation Package.

1013. The application of paragraph 2 is subject to two other conditions which are reflected in subparagraphs (b) and (c):

- the closing date of the Period is on or after the 1st of April; this condition is meant to avoid a disproportionate administrative burden;
- the Convention has entered into force in that Party on the initial date described by Article 48(1); the specific date of entry into effect provided under paragraph 2 will not be applicable to Parties which join the MLC at a later stage.

For example, where the first day of the calendar year described in paragraph 1, based on the initial entry into force date described by Article 48(1), is 1 January 2026, and the Covered Group has a Period that begins on 1 October and ends on 30 September of the following year, there would be a need to determine if any Group Entities of the Covered Group have been subject to at least one of the measures listed in Annex A during the period of 1 January 2025 to 31 December 2025. If so, paragraph 2 will apply. This means that the Convention will enter into effect in a Party with respect to this Covered Group on 1 January 2026. If another Covered Group has a Period that begins on 1 February and ends on 31 January of the following year, paragraph 2 will not apply.

Paragraph 3

1014. Paragraph 3 requires adjustments in the application of the Convention for Covered Groups which fall under paragraph 2. The effect of paragraph 3 is that a Covered Group is required to undertake the entirety of the Amount A calculations as if the entire Period in which the date of entry into effect falls was in scope. After all the relevant calculations have been undertaken on a full Period basis, the Amount A Profit is allocated to market jurisdictions (and subsequent adjustments made, if necessary, in accordance with Article 4(2)) and the *Amount A relief amount* is allocated to *relieving jurisdictions*, the Amount A Profit subject to tax and the *Amount A relief amount* are then adjusted proportionately on the basis of how much of the initial Period is after the date of entry into effect.

1015. Paragraph 3(a)(i) requires Parties to adjust the amount of Amount A profit that is taxed under Article 4. The Amount A Profit subject to tax under Article 4 is adjusted by reference to the number of days in the initial Period which were on or after the date of entry into effect. This adjustment occurs after any required adjustments have been undertaken in accordance with Article 4(2). Paragraph 3(a)(i) does not adjust any Amount A Profit other than for purposes of Article 4.

1016. Paragraph 3(a)(ii) provides a similar adjustment but in relation to the *Amount A relief amount*. Further, the adjustment in paragraph 3(a)(ii) applies after the relevant calculations have been undertaken under Article 11(6) through (15). As such, the *Amount A relief amount* as relevant to Articles 9, 12 and 13 is adjusted, without disturbing the allocation rules in Article 11. Therefore, the Amount A relief allocated to a *specified jurisdiction* under Article 9 is adjusted by reference to the number of days in the initial Period which were on or after the date of entry into effect.

1017. Subparagraph 3(a)(iii) notes that where the number of days of the initial Period that are on or after the date of entry into effect are fewer than 183 (including the date of entry into effect and the last day of the initial Period), then the following phases and periods shall be extended so as to include the initial Period:

- the *initial revenue sourcing transitional phase*;
- the *initial extractives transitional phase*;
- the *regulated financial services transitional period*;
- the *mixed segment entity transitional period*;
- the transition period with respect to the Withholding Tax Upward Adjustment described in Annex B Section 6(7);
- the transition period with respect to the level of the materiality threshold of the definition of a “related issue” as per Article 34(3)(a).

This means the transitional regime will apply during the Period of less than 183 days, but without this Period counting in the determination of the regime’s maximum number of Periods.

1018. While Article 3(10) adjusts any monetary amount in the Convention for Periods which are either shorter than or longer than twelve months, it will not apply in the scenarios envisaged in paragraphs 2 and 3. This is because, paragraphs 2 and 3 adjust a full length Period where only part of that Period is after the date of entry into effect in a Party, while Article 3(10) adjusts the monetary amounts in the Convention to correspond to a partial or extended Period.

1019. Subparagraph (b) provides for an adjustment to be made for a Covered Group for which paragraphs 2 applies. The adjustment in subparagraph (b) does not disturb the allocation to *relieving jurisdictions* under Article 11. However, to ensure that in circumstances where there may be an unallocated relief amount in the initial Period, a similar adjustment is required to the provisions giving effect to any *prior unallocated Amount A relief* occurring in the initial Period. Therefore, subparagraph 3(b)(ii) requires an adjustment to any *prior unallocated Amount A relief* attributable to the initial Period, on the same basis as the adjustment to the Amount A relief of each *relieving jurisdiction* in the initial Period. For example, where the date of entry into effect is 1 January 2026, for a Covered Group with a Period that begins on 1 October 2025 and ends on 30 September 2026, the adjustments provided in paragraphs 3(a)(i) and (ii) and (b)(ii)

will be based on a fraction of 273 days (i.e. for the period of 1 January 2026 to 30 September 2026) over 365 days (i.e. for the initial Period of 1 October 2025 to 30 September 2026).

Paragraph 4

1020. Paragraph 4 provides that Article 38(1) (Removal of Existing Measures) shall have effect in a Party as of the first day of the next calendar year that begins on or after the expiration of a period of six months from the date on which the Convention enters into force for that Party.

Paragraph 5

1021. Paragraph 5 provides an expedited entry into effect of the provisions relating to the establishment of a *standing pool* of independent experts for purposes of Amount A *determination panels* under Article 28 as well as the review process and early clarification on digital services taxes and relevant similar measures. This means that as of the entry into force of the Convention (and regardless of whether the other provisions of the Convention have started to take effect with respect to a Party): (1) the process of establishing a *standing pool* of experts may start; and (2) a Party may request that the Conference of the Parties determine whether a measure meets the definition of *digital services taxes or relevant similar measures* under Article 39.

Paragraph 6

1022. Paragraph 6 specifies that the provisions of Article 47 (Conference of the Parties) shall have effect as of the date of entry into force of the Convention. This will allow the Conference of the Parties to swiftly convene and begin to perform its functions as of that date.

Paragraph 7

1023. This paragraph is related to Article 46, which provides that in the event of a conflict between the provisions of the Convention and the provisions of any Existing Tax Agreement between two or more Parties, the provisions of the Convention shall prevail to the extent of the conflict. Paragraph 7 provides that this precedence will take effect as soon as the Convention is in force for each of the Parties to the Existing Tax Agreement.

Article 50 – Withdrawal

Paragraph 1

1024. Paragraph 1 clarifies that the Parties are not allowed to withdraw from the Convention during an initial period of five years after its entry into force. Following this initial period, a Party may notify at any time the Depositary of its intention to withdraw or its intention not to apply the Convention with respect to a jurisdiction or territory for which it has territorially extended coverage of the Convention under Article 42(1). The Depositary shall inform the Parties and Signatories of any notification of withdrawal.

Paragraph 2

1025. Paragraph 2 defines the notice period for a request of withdrawal to take effect. It provides for a delay of twelve months from the notification of the withdrawal, during which the Party has the ability to retract its withdrawal by means of a notification addressed to the Depositary. The delay between the

notification of withdrawal and it taking effect aims at ensuring that the Parties have the opportunity to discuss the matter as set under paragraph 3.

1026. Absent a retraction, the provisions of the Convention cease to have effect in the Party with respect to any Period of a Covered Group beginning on or after the first day of the next calendar year that begins on or after the expiration of the twelve months delay. This means that for each Covered Group, the last Period in which the Convention has effect is the Period starting in the calendar year when the twelve months delay expires and the Convention ceases to have effect on the last day of that Period.

1027. When the withdrawal takes effect with respect to a Period, a former Party will no longer have rights and obligations under the Convention with respect to that Period and subsequent Periods, therefore in particular (i) losing its taxing rights under Amount A; (ii) not being under any obligation to relieve double taxation. The provisions of Annex B Section 3 on the identification of the Designated Payment Entity of a Covered Group in case the Ultimate Parent Entity is not a resident of a Party and of Article 4(2) on the adjustments to Amount A Profit that may be taxed in a Party in case a *relieving jurisdiction* is not a Party shall apply as relevant with respect to a former Party. After the withdrawal takes effect, the former Party nevertheless retains its rights and obligations under the Convention with respect to Periods beginning before the effective date of withdrawal.

1028. For example, if a Party notifies its withdrawal on 30 September of year X, and does not retract it, the Convention will cease to have effect in the Party with respect to any Period of a Covered Group beginning on or after 1 January of year X + 2. With respect to Group A whose periods end on 31 December, the last Period when the Convention applies is 1 January – 31 December of year X + 1. With respect to Group B whose periods end on 31 March, the last Period when the Convention applies is 1 April of year X + 1 – 31 March of year X + 2.

Paragraph 3

1029. Paragraph 3 provides that a meeting of the Conference of the Parties may be convened by the Depositary following receipt of a notification of withdrawal to ensure that the Parties can discuss the matter. This provision is intended to give Parties an opportunity to discuss and address the concerns raised by the withdrawing Party.

Article 51 – Termination

Paragraph 1

1030. Paragraph 1 provides that the Parties may decide by *consensus* to terminate the Convention as of a specified date.

Paragraph 2

1031. Paragraph 2 provides for automatic termination of the Convention where the withdrawal of a Party causes the remaining Parties to account for less than 550 points, using the point values assigned in Annex I or in the most recently updated assignment of points pursuant to Article 47(4). The date of termination is the effective date of that withdrawal.

Paragraph 3

1032. Paragraph 3 specifies that if the Convention is terminated pursuant to Article 43(7), the date of termination is three months after the date described in Article 43(6).

Paragraph 4

1033. Paragraph 4 provides when the termination of the Convention shall take effect. All the provisions will cease to have effect with respect to any Period of a Covered Group beginning on or after the first day of the next calendar year that begins on or after the termination date.

Article 52 - Relation with protocols**Paragraph 1**

1034. Paragraph 1 provides that the Convention may be supplemented by one or more protocols.

Paragraph 2

1035. Paragraph 2 clarifies that any protocol to the Convention will be open only to the parties to the Convention.

Paragraph 3

1036. Paragraph 3 provides that a Party to the Convention would not be bound by any protocol unless it becomes a party to the protocol in accordance with its provisions.

Article 53 – Depositary**Paragraph 1**

1037. Paragraph 1 provides that the Secretary-General of the OECD is the Depositary of the Convention and any protocols pursuant to Article 52.

Paragraph 2

1038. Paragraph 2 sets out in subparagraph (a) a non-exhaustive list of the acts or communications in relation to the Convention of which the Depositary will notify all Parties and Signatories. The Depositary must notify the Parties and Signatories within one month of the act or communication. Subparagraph (b) also clarifies that the Depositary shall maintain publicly available lists of Parties for which the provisions of the Convention are in effect pursuant to Article 49 as well as publicly available lists of notifications made by the Parties.

Annex B – Supplementary definitions related to Article 2

Section 1 – Excluded Entities

Governmental entity

1039. A *governmental entity* is one of the types of Entities excluded from the scope of the Convention because they are an Excluded Entity. *Governmental entities* are excluded because they are sovereign entities that are not typically subject to tax in their own Jurisdiction and often benefit from exclusions from taxation under foreign domestic law or tax treaties. In order to be a *governmental entity* for purposes of the Convention, the Entity must:

- a) be part of or wholly-owned by a government (including any political subdivision or local authority thereof);
- b) not carry on a trade or business and have the principal purpose of fulfilling a government function or managing or investing that government's or Jurisdiction's assets;
- c) be accountable to the government on its overall performance, and provide annual information reporting to the government;
- d) distribute any earnings to the government and vest its assets in the government upon dissolution.

1040. Each of these criteria are discussed in further detail below.

Subdivision (i)

1041. Subdivision (i) provides that the Entity must be part of the government or wholly owned by a government (including any political subdivision or local authority thereof). The phrase "part of" means an Entity that is created under public law. The reference to "wholly owned by a government" extends the application of subdivision (i) to corporations or other Entities created under private law provided that they are wholly owned (directly or indirectly) by a government. The word "government" means the central administration, agencies whose operations are under its effective control, state and local governments and their administration.

Subdivisions (ii) and (iii)

1042. Subdivisions (ii) and (iii) set limits on the type of activities an Entity can undertake in order to qualify as a *governmental entity*. Subdivision (ii) requires that the Entity does not conduct a trade or business and therefore excludes commercial enterprises owned by a government from meeting the definition. Subdivision (iii) requires that the principal purpose of the Entity must be: (A) fulfilling a government function; or (B) managing or investing that government's or Jurisdiction's assets through the making and holding of investments, asset management, and related investment activities for the government's or Jurisdiction's assets.

1043. For instance, a sovereign wealth fund should meet both of these conditions because it would not be carrying out commercial activities that could constitute a trade or business and its activities would typically be limited to those referred to in subdivision (iii). Similarly, if the government (including a *governmental entity*) incorporates an Entity that meets all the other requirements in the definition and that

Entity only provides products or services for use by that government to fulfil a governmental function, then the activities of the Entity are assimilated to a government function rather than a trade or business and therefore both subdivisions (ii) and (iii) will met. On the other hand, an airline owned by the government would not meet the conditions in subdivision (ii) as it would be engaged in a trade or business, even though it may be considered to meet subdivision (iii) through having the principal purpose of fulfilling a government function, and therefore it would not meet the definition of *governmental entity*.

1044. The “government function” in clause (A) is a broad term that is intended to include activities such as providing public health care and education or building public infrastructure or ensuring defence capability and law enforcement within the Jurisdiction. The condition in clause (B) is intended to include Entities such as sovereign wealth funds (including those incorporated as companies) which governments typically use to hold and manage their investments. Sovereign wealth funds are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatisations, fiscal surpluses or receipts resulting from commodity exports (See International Working Group of Sovereign Wealth Funds, *Sovereign Wealth Funds — Generally Accepted Principles and Practices — “Santiago Principles”* (IWG, 2008[15]), October 2008, Annex 1; also replicated in the OECD Model, Commentary on Article 4, paragraph 8.5.). The function of a sovereign wealth fund is to invest these amounts for the purpose of managing a Jurisdiction’s future fiscal needs, stabilising a Jurisdiction’s balance of payments and in order to strike an appropriate balance between domestic consumption and saving.

Subdivision (iv)

1045. Subdivision (iv) requires that the Entity is accountable to the government (including a *governmental entity*) on its overall performance, and provides annual information reporting to the government (including a *governmental entity*).

Subdivision (v)

1046. Lastly, the condition in subdivision (v) requires that if the Entity distributes its net earnings that these are paid to the government (including a *governmental entity*), and upon dissolution of the Entity its assets will vest in the government (including a *governmental entity*). In considering whether a distribution of earnings is made to a person other than government the facts and circumstances of the payment need to be taken into account. For example, a central bank that is organised as a company under public law issues part of its shares to private shareholders who are entitled to a fixed return based on their contributions. The central bank is controlled by the government and upon dissolution all of its assets are vested to the government and not the private shareholders. Under these specific facts and circumstances, the privately held shares are, in substance, similar to a financing instrument that is assimilated to the return of long-term bonds rather than shares. The return is therefore not considered a distribution of net earnings.

International organisation

1047. An *international organisation* is one of the types of Entity excluded from the Convention because they are an Excluded Entity. The rationale for excluding *international organisations* is similar to that for the exclusion for *governmental entities*.

1048. The definition of *international organisation* aligns with the one used in the Standard for Automatic Exchange of Financial Account Information in Tax Matters. Consistent with the commentary to that standard, a “substantially similar agreement” described in subdivision (ii) is intended to cover arrangements that entitle the organisation’s offices or establishments in the Jurisdiction (e.g. a subdivision, or a local, or regional office) to privileges and immunities.

Investment fund

1049. The definition of an *investment fund* draws upon the definition of an “investment entity” according to International Financial Reporting Standard 10 and the European Union Alternative Investment Fund Managers Directive 2011/61/EU (the AIFMD). To meet the definition of an *investment fund*, an Entity has to meet all of the following criteria:

- i) it is designed to pool assets (which may be financial and non-financial) from a number of investors (some of which are not *connected*);
- ii) it invests in accordance with a defined investment policy;
- iii) it allows investors to reduce transaction, research, and analytical costs, or to spread risk collectively;
- iv) it is primarily designed to generate investment income or gains, or to provide protection against a particular or general event or outcome;
- v) investors have a right to return from the assets of the fund or income earned on those assets, based on the contributions made by those investors;
- vi) the Entity or its management is subject to a regulatory regime in the Jurisdiction in which it is established or managed (including appropriate anti-money laundering and investor protection regulation); and
- vii) it is managed by investment fund management professionals on behalf of the investors.

1050. Each of these criteria is discussed in further detail below.

Subdivision (i)

1051. Subdivision (i) requires the Entity to be designed to pool assets (financial and non-financial) from a number of investors (some of which are not connected). An investor could contribute cash or other kinds of liquid assets, or non-liquid assets such as *immovable property* to an *investment fund*.

1052. Subdivision (i) requires that some of the investors of the fund are not connected. The term connected is defined in Annex B Section 1(h) and draws on Article 5(8) of the OECD Model and on Article 5(9) of the UN Model. Although the term “connected”, rather than the term “closely-related” as found in Article 5(8) of the OECD Model and in 5(9) of the UN Model, is used, paragraphs 119 through 121 of the Commentary on Article 5 of the OECD Model are relevant to the interpretation of this subdivision and Article 3, as well as paragraphs 2 and 3 of the Commentary on Article 3 of the OECD Model which provide the meaning of the terms “person” and “company”. A facts and circumstances test should be applied to determine whether two or more investors are connected, or in the case of individuals, whether they are Family Members (defined in Article 2) of the same family. In any case, an investor should be treated as connected to another investor if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s share or the beneficial equity interest that carries rights to the profits, capital or reserves of the company), or if another person possesses directly or indirectly more than 50 per cent of the beneficial interests in each person (or in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s share or the beneficial equity interest in the company). Furthermore, two or more companies should be treated as connected to each other where more than 50 per cent of the aggregate vote and value of each company’s shares or of the beneficial equity interest that carries rights to the profits,

capital or reserves of each company are possessed by individuals that are Family Members of the same family. In some instances, a fund will only have one investor for a short period of time, even though the fund is designed to pool assets for more than one unrelated investor. For example, a fund might have a single investor when the entity is within the initial offering period or in the process of liquidation. A fund in these circumstances with only one investor will meet the criteria of subparagraph (a) provided that the fund was designed to pool assets from a number of investors (some of which are not *connected*).

Subdivision (ii)

1053. Subdivision (ii) requires an *investment fund* to have a defined investment policy and to invest according to that policy. Some factors that would, singly or cumulatively, tend to indicate the existence of such a policy are the following:

- a) the investment policy is determined and fixed, at the latest by the time that investors' commitments to the *investment fund* become binding on them;
- b) the investment policy is set out in a document which becomes part of or is referenced in the rules or instruments of incorporation of the *investment fund*;
- c) the *investment fund* or the legal person managing the *investment fund* has an obligation (however arising) to investors, which is legally enforceable by them, to follow the investment policy, including all changes to it; and
- d) the investment policy specifies investment guidelines, with reference to criteria including any or all of the following: (i) to invest in certain categories of assets, or conform to restrictions on asset allocation; (ii) to pursue certain strategies; (iii) to invest in particular geographical regions; (iv) to conform to restrictions on leverage; (v) to conform to minimum holding periods; or (vi) to conform to other restrictions designed to provide risk diversification.

Subdivision (iii)

1054. Subdivision (iii) requires the *investment fund* to be an entity that allows investors to reduce transaction, research and analytical costs, or to spread risk collectively. An Entity that is designed to undertake a particular function for members of a Group (such as centralised financial or procurement services) could be described as reducing transaction costs or spreading risks. Nevertheless, such an Entity could not meet the wider definition of an *investment fund*.

Subdivision (iv)

1055. To qualify as an *investment fund*, the Entity must primarily be designed to generate investment income or gains, as opposed to operating income. The income generated through the fund has to be income that is derived from investment holdings, such as dividends, interest, rent, returns from other *investment funds* and capital gains. Royalties are not included in this category. An alternative condition is that the fund is designed for protection against a particular or general event or outcome. This wording is intended to cover situations where an *investment fund* is used by firms in the insurance industry to cover insured events or outcomes.

Subdivision (v)

1056. Subdivision (v) requires the investors to have a right to the return from the assets of the fund or income earned on those assets based on the contributions made by the investors. Investors may also earn capital gains from the disposal of equity interests of the fund.

Subdivision (vi)

1057. The requirement under subdivision (vi) is that the fund or the fund manager is subject to a regulatory regime in the Jurisdiction in which it is established or managed (including appropriate anti-money laundering and investor protection regulation). This subparagraph is intended to encompass the different approaches to prudential regulation of *investment funds*. For an *investment fund* that is established or created by a government or that acts as an agent or mandatary of a government, to the extent that it does not qualify as a *governmental entity*, regulation may take any form endorsed by the government, for example provisions for accountability and review contained in the legislation under which the *investment fund* is constituted.

Subdivision (vii)

1058. Finally, subdivision (vii) requires the fund to be managed by professionals on behalf of the investors. The factors that would, singly or cumulatively, tend to indicate that the fund is managed by fund management professionals, include the following:

- a) the fund managers operate independently of the investors, and are not directly employed by the investors;
- b) the fund managers are subject to domestic regulation regarding knowledge and competence;
- c) management compensation for services rendered is partly based on the performance of the fund.

Non-profit organisation

1059. A *non-profit organisation* is one of the types of Entity excluded from the scope of the Convention because it is an Excluded Entity. The definition of *non-profit organisation* is based on subparagraph (h) of the definition of “Active Non-Financial Entity (NFE)” included in Section VIII (Defined Terms) in the Standard for Automatic Exchange of Financial Account Information in Tax Matters.

1060. Subdivision (i) of the definition sets out the general purposive criteria of the *non-profit organisation* definition. A *non-profit organisation* is an Entity established and operated in its Jurisdiction of residence exclusively for religious, charitable, scientific, artistic, cultural, athletic, educational, or other similar purposes such as public health, the advancement and protection of human rights or animal rights, or environmental protection. It also includes a professional organisation, business league, chamber of commerce, labour organisation, agricultural or horticultural organisation, civic league or an organisation operated exclusively for the promotion of social welfare or other similar purposes. A *non-profit organisation* is resident in the Jurisdiction in which it is created and managed.

1061. Subdivisions (ii) and (iii) require that substantially all of the Entity’s income is tax-exempt for local tax purposes and that the Entity has no shareholders or members with a beneficial interest in its income or assets.

1062. Subdivision (iv) of the definition sets the principle that the income or assets of the Entity may not be distributed or applied for the benefit of a private person or a non-charitable Entity. It then states three exceptions:

- A) the first exception is where the distribution or benefit is pursuant to the conduct of the Entity’s charitable activities. For instance, where an alumni foundation of a university is funding the education expenses of students that need aid.

- B) the second exception is where there is a payment of reasonable compensation for services rendered or for the use of property or capital. For instance, where an Entity makes rental payments to a private person for the right to use office space or other premises needed for its operation.
- C) the third exception is where the Entity makes a payment representing the fair market value of property which the entity has purchased. For example, where an organisation buys *immovable property* from a private person at fair market value to establish its offices.

1063. Subdivision (v) states that upon termination, liquidation or dissolution of the Entity, all of its assets must be distributed or revert to a *non-profit organisation* or to the government (including any *governmental entity*) of the Entity's Jurisdiction of residence or any political subdivision thereof.

1064. The analysis to be made under subdivision (v) has to take into account, for example, the articles of incorporation of the Entity or any other arrangement, as well as the applicable provisions (including guidance) under domestic law, that determine the persons or Entities that have the rights of the assets when it is terminated, liquidated or dissolved.

1065. The tailing clause of the definition includes a general condition that disqualifies any Entity that carries on a trade or business that is not directly related to the purposes for which it was established. For example, an Entity that sells shirts or other products with its logo as part of its activities to raise funds for the organisation would not be disqualified by this condition because such business is related to the purposes for which it was established. On the other hand, an Entity that is exclusively dedicated to selling products would not qualify under this condition even if it gives up its profits to a good cause. An Entity that meets the definition of a *non-profit organisation* may be the Ultimate Parent Entity of a Group. However, an Entity that simply serves as the holding company for an internationally operating commercial business will not qualify as a *non-profit organisation* merely because it is classified as a non-profit foundation or similar under local tax rules.

Pension fund

1066. A *pension fund* is one of the types of Entity excluded from the scope of the Convention. Under subdivision (i), a *pension fund* is an Entity that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary and incidental benefits to individuals.

1067. Clause (A) of the definition of *pension fund* is based on the definition of "recognised pension fund" included in Article 3(1)(i) of the OECD Model and in Article 3(1)(g) of the UN Model. The Commentary on the definition of this term in the OECD Model is therefore also relevant, subject to the differences in context between the Convention and tax treaties. The definition differs from that used in the OECD Model because it has been modified to remove reference to the fund being taxable as a separate person in the Jurisdiction of establishment, to allow for *pension funds* formed as different legal arrangements, such as a trust. The definition applies to both public and private *pension funds*.

1068. Clause (B) of the definition extends the definition of *pension fund* to include a fund that is not regulated as such, but is held by a trust or other fiduciary arrangement in order to meet pension obligations that are secured or otherwise protected by domestic regulation. This extended definition is intended to cover any situation where an Entity is not subject to regulation as a *pension fund* but is established to administer or provide retirement benefits, and those benefits are secured or otherwise protected by domestic regulations and funded by a pool of assets held through a fiduciary arrangement or trust to secure the fulfilment of the corresponding pension obligations. For example, this covers self-administered *pension*

funds where a Group administers the funds for the benefit of its employees where these benefits are themselves secured through domestic regulation.

1069. Subdivision (ii) states that a *pension fund* includes a *pension services entity*. The definition of a *pension services entity* is described in further detail below.

Pension services entity

1070. The definition of a *pension services entity* is used in the definition of *pension fund*. It is also referred to in subdivision (ii) of the definition of Excluded Entity because Entities owned by *pension services entities* cannot be Excluded Entities.

1071. The definition covers two types of Entities. The first type is described in subdivision (i), which refers to an Entity established to operate exclusively or almost exclusively to invest funds for the benefit of a *pension fund*. The second type of *pension services entity* is one that is established and operated exclusively or almost exclusively to carry out activities that are ancillary to the regulated activities that are carried out by the *pension fund*.

1072. Subdivision (ii) does not require the Entity to provide services directly to a *pension fund* as defined by subdivision (i) of the definition of *pension fund*. It only requires that its activities are ancillary to the regulated activities carried out by the *pension fund* and that the Entity and the *pension fund* are members of the same Group. For example, a *pension fund* that meets the requirements of subdivision (i) of the definition of *pension fund* incorporates an Entity (A Co) to serve as its fund manager. A Co, which is responsible for the *pension fund's* investment strategy, incorporates another Entity located in Jurisdiction B (B Co), which provides advisory services to A Co on investment opportunities in Jurisdiction B. All of the Entities involved would be members of the same Group. In this case, B Co is a *pension services entity* notwithstanding that it is not providing services directly to the *pension fund* because its activities are ancillary to those of the *pension fund*.

1073. The phrase “exclusively or almost exclusively” denotes a facts and circumstances test that requires that all or almost all of the activities of the Entity have to be the ones referred to in subdivision (i) or (ii). This phrase draws on the language used in the definition of a “recognised pension fund” in Article 3 of the OECD Model (see paragraph 10.11 on the Commentary on Article 3).

Real estate investment vehicle

1074. As with an *investment fund*, a *real estate investment vehicle* that satisfies subdivision (i) of the definition of an Ultimate Parent Entity is an Excluded Entity. While in many cases, these investment vehicles would qualify as Excluded Entities by virtue of being *investment funds*, in certain cases *real estate investment vehicles* may not be subject to the necessary regulation or managed by *investment fund* management professionals to satisfy the requirements of subdivision (vi) or (vii) of the definition of *investment fund*. Accordingly *real estate investment vehicles* are identified as a separate category of Excluded Entity.

1075. A *real estate investment vehicle* is a widely-held Entity that holds predominantly *immovable property*. The definition draws on the “special tax regime” provision included in paragraph 86 of the Commentary on Article 1 of the OECD Model. A widely held Entity is one that has many owners that are not *connected* persons. The term *connected* is defined in Annex B Section 1(h) (see paragraph 1052 of the Explanatory Statement for further guidance). A *real estate investment vehicle* that is owned directly by a small number of other widely-held *investment funds* or *pension funds* that have numerous beneficiaries is considered to be widely held.

1076. One of the conditions set out in the definition is that *real estate investment vehicle* achieves a single level of taxation (with at most one year of deferral). The intention of this language is to deal with tax neutral vehicles which are designed to ensure that a single level of taxation is achieved either in the hands of the vehicle or its equity interest holders. This could be the case of an exempt entity provided that it distributes its income within a certain time period. The distribution is then subject to tax in order to achieve a single level of taxation. Furthermore, this also includes a situation where part of the income is subject to tax at the fund level and the remaining part at the investor level.

1077. In some situations, however, the interest holders could also be tax neutral vehicles such as a recognised *pension fund*. In these cases, on a strict reading, a single level of taxation would not be achieved within a year as the distributions made to these investors could be exempted. However, the definition would still be met because the design of the tax regime was to achieve a single level of taxation.

1078. The definition also requires that the Entity holds predominantly *immovable property*. That property might also be held indirectly by means of a security whose value is linked to *immovable property*. An Entity that holds predominantly *immovable property*, either directly or indirectly through such a security (or a combination of the two) will meet the condition of the definition.

Section 2 – Adjusted Profit Before Tax of a Covered Group

1079. Annex B Section 2 defines the “Adjusted Profit Before Tax” of a Covered Group, which is used as the basis for a number of operative provisions of the Convention. It also contains a number of terms used in that definition.

Paragraph 1

Adjusted Profit Before Tax

1080. Paragraph 1 contains the core definition of the term “Adjusted Profit Before Tax”. The calculation starts with the Financial Accounting Profit (or Loss) of the Covered Group for a period under an Acceptable Financial Accounting Standard. The Financial Accounting Profit (or Loss) is then subject to a series of book-to-tax adjustments, a “prior period adjustment” and an adjustment with respect to the Entity Financial Accounting Profit (or Loss) of Excluded Entities. Finally, where the amount of the Financial Accounting Profit (or Loss) is positive after these adjustments, *relevant net losses* are deducted up to this positive amount.

1081. For purposes of the calculation the Financial Accounting Profit (or Loss) is defined in Article 2(u) to mean the profit or loss recognised in the Consolidated Financial Statements of the Ultimate Parent Entity of a Group, taking into account all of the Group’s revenue and expenses (excluding items included in the computation of “other comprehensive income”), including income tax. In other words, Financial Accounting Profit (or Loss) is the bottom-line of the profit or loss statement of the Consolidated Financial Statements of the Ultimate Parent Entity of the Group. The definition of Consolidated Financial Statements is included in Article 2(d) as discussed at paragraph 60 of this Explanatory Statement.

Book-to-tax Adjustments

1082. Paragraph 1(a) provides an exclusive list of items of income and expense that are taken into account in the calculation of Financial Accounting Profit (or Loss) but must be reversed in the calculation of the “Adjusted Profit Before Tax” of the Covered Group. This list includes the following items, each of

which is described in more detail below: (i) tax expense or tax income; (ii) dividends or other distributions; (iii) gain, profit or loss with respect to certain equity interests; (iv) expenses for illegal payments; and (v) expenses for fines and penalties that equal or exceed EUR 50 000 or an equivalent in the functional currency for a Group Entity.

1083. Subparagraph (a)(i) provides for the reversal of income tax expense (or income) that was included in calculating the Financial Accounting Profit (or Loss) of a Covered Group under an Acceptable Financial Accounting Standard. This item is excluded on the basis that income tax expenses are usually not deductible for corporate income tax purposes in Inclusive Framework jurisdictions. It covers both current and deferred income tax expense (or income). Current income tax expense (or income) is the amount of income tax that a Group would be expected to pay (or recover) in respect of the Period, whilst amounts of income tax payable (or recoverable) in respect of future Periods are recognised as deferred tax liabilities (or assets). The characterisation of a particular tax or levy as income tax for purposes of this provision depends on its treatment under the applicable Acceptable Financial Accounting Standard. Generally, financial accounting standards define income taxes broadly, including all domestic and foreign taxes based on *taxable profits*, and taxes on distributed profits such as withholding taxes. Accordingly, the deduction of these taxes in the calculation of the Financial Accounting Profit (or Loss) will be reversed in the calculation of the Adjusted Profit Before Tax to the extent they are considered current or deferred income tax expense (or income) under the applicable Acceptable Financial Accounting Standard. In contrast, the deduction of taxes not considered current or deferred income tax expense (or income) under the applicable Acceptable Financial Accounting Standard in the calculation of the Financial Accounting Profit (or Loss) will not be adjusted in the calculation of the Adjusted Profit Before Tax. For example, customs and excise duties are not considered to be current and deferred income tax expense (or income) under applicable Acceptable Financial Accounting Standards.

1084. In addition, subparagraph (a)(i) does not include interest charges for late payment of tax. In general, Covered Groups may be subject to interest charges for late payments of an amount of income tax due, but depending on the particular financial accounting standard, those interest charges can be recognised as either a tax expense or a financial charge. Therefore, allowing a deduction for this type of interest charge in computing the Adjusted Profit Before Tax ensures consistency in the treatment of interest charges. Also for reasons of neutrality, deductions for tax penalties will be reversed in many cases, regardless of their treatment under an Acceptable Financial Accounting Standard. Where tax penalties are recognised as a tax expense under an Acceptable Financial Accounting Standard, the deduction of tax penalties will be reversed from the Adjusted Profit Before Tax under subparagraph 1(a)(i). In other cases, where a tax penalty is not recognised as a tax expense under an Acceptable Financial Accounting Standard, the deduction of the penalty would be reversed from the Adjusted Profit Before Tax under paragraph 1(a)(v) provided it meets the threshold in that provision.

1085. Subparagraph (a)(ii) provides for the reversal of dividends or other distributions received or accrued in respect of Specified Equity Interest that were reflected in the Financial Accounting Profit (or Loss) of a Covered Group under an Acceptable Financial Accounting Standard. This item is excluded on the basis that (a) dividends represent a distribution of profits earned by investee entity that have been included in the Adjusted Profit Before Tax of such entity and the inclusion of dividend income in the investor entity would represent a double counting of the same income, and because (b) dividends are excluded, in whole or in part, from the corporate income tax base in many Inclusive Framework jurisdictions, or, in other instances, the recipient benefits from tax relief (such as indirect credit for taxes paid). This provision covers dividends or other distributions of profits regardless of their form or the percentage of equity ownership interest of the recipient. No adjustment will generally be needed under subparagraph (a)(ii) with respect to dividends or other distributions received by Group Entities of the Covered Group from controlled Entities and Entities reported under the equity method as they are typically excluded from the calculation of the Covered Group's Financial Accounting Profit (or Loss) under Acceptable Financial Accounting Standards.

1086. Subparagraph (a)(iii) provides for the reversal of gain, profit or loss arising from a series of items attributable to Specified Equity Interests: (i) disposition of a Specified Equity Interest ; (ii) changes in the fair value of a Specified Equity Interest; and (iii) profit or loss in respect of a Specified Equity Interest included under the equity method of accounting in the Consolidated Financial Statements of the Covered Group under an Acceptable Financial Accounting Standard, other than profit or loss derived from a Joint Venture unless that Joint Venture is the Ultimate Parent Entity of another Covered Group.

1087. Subparagraph (a)(iii)(A) refers to gains and losses arising from a disposition of a Specified Equity Interest in any Entity. It is considered that inclusion of gains or losses from disposition of Specified Equity Interests in the Adjusted Profit Before Tax would result in double-counting of income on the basis that such gains largely relate to the expected future profits of the investee entity, and will commonly be included in the Adjusted Profit Before Tax of the investee entities if they are also in scope of the Convention. On this basis, such gains and losses are excluded.

1088. Subparagraph (a)(iii)(B) relates to changes in the fair value of a Specified Equity Interest that is accounted for using a fair value accounting method, including mark-to-market. A fair value method re-values the Specified Equity Interest periodically, with changes in value reported as gain or loss, either in the profit and loss statement or in the other comprehensive income section of the balance sheet. Fair value method gains or losses in respect of Specified Equity Interests are excluded from the Adjusted Profit Before Tax computation. This is because such gains or losses represent changes in the projected future cash flows generated from the underlying investee, where those cash flows will typically derive from profits included in the Adjusted Profit Before Tax of the investee entity or its controlling interest holder (or from other sources that are specifically excluded from the Adjusted Profit Before Tax of the investee) and the inclusion of such income in the investor entity would represent a double counting of the same income. Accordingly, excluded fair value gains require a negative adjustment and excluded fair value losses require a positive adjustment to the Financial Accounting Profit (or Loss). To the extent such fair value gains and losses are recorded in other comprehensive income or equity instead of the profit and loss statement, they may already have been excluded from the Adjusted Profit Before Tax and no adjustment is necessary under clause (B). It is noted that this specific provision with respect to Specified Equity Interests accounted for under fair value accounting included in subparagraph (a)(iii)(B) shall take precedence over the reversal in subparagraph (b)(i)(A) where both would otherwise apply.

1089. Subparagraph (a)(iii)(C) relates to profit or loss arising from a Specified Equity Interest accounted for using the equity method of accounting in the Consolidated Financial Statements of the Covered Group, in which the Covered Group has joint control unless that Joint Venture is the Ultimate Parent Entity of another Covered Group. This is because such profit or loss have been included in the Adjusted Profit Before Tax of the investee entity or its controlling interest holder, and the inclusion of such income in the investor entity would represent a double counting of the same income. The adjustment required in respect of Specified Equity Interests accounted for under the equity method may be a positive or negative amount depending upon whether the Covered Group reported net income or net loss. An equity method net income is a negative adjustment to the Financial Accounting Profit (or Loss). An equity method loss is a positive adjustment to the Financial Accounting Profit (or Loss). Financial accounting standards typically require equity method accounting when the Covered Group holds a significant but non-controlling interest in an entity, ordinarily between 20 per cent and 50 per cent of the equity ownership interests in an entity.

1090. Profit or loss derived from Joint Ventures is an exception to this reversal. This is on the basis that Joint Ventures are not consolidated on a line-by-line basis under an Acceptable Financial Accounting Standard in the accounts of any other group on the basis that they are jointly controlled, and thus it is necessary to include the profits of a Joint Venture proportionately in the Adjusted Profit Before Tax of its owners to avoid such income being ignored for purposes of the Convention. Accordingly, profit or loss recognised in the Financial Accounting Profit (or Loss) of a Covered Group that derives from an interest in

a Joint Venture will not be subject to an adjustment under subparagraph (a)(iii)(C). For example, assume Group A is a Covered Group that has a 25 per cent equity ownership interest in a Joint Venture. Assume further that the Joint Venture recognises a profit of 100 in its profit or loss statement in Year 1. Group A reports a financial accounting profit of 500 in the same period, which accordingly includes a profit of 25 recognised under the equity method from its investment in the Joint Venture. Other things being equal, the Adjusted Profit Before Tax of Group A would be 500 as the profit from its investment in the Joint Venture is not subject to a reversal under subparagraph (a)(iii)(C).

1091. For purposes of this exception, a Joint Venture does not require the Covered Group to have a minimum percentage of ownership. However, it requires all the parties, or a group of the parties, to the arrangement, including the Covered Group, to have joint control and rights to the net assets of the Joint Venture. Though joint control generally requires the unanimous consent of all the parties with respect to decisions about the activities of the Joint Venture, the reference to joint control must be specifically considered in the context of the Acceptable Financial Accounting Standard used by the Covered Group to produce its Consolidated Financial Statements. It also requires that the profit or loss of the Joint Venture be recognised under the equity method of accounting.

1092. In the case that a Joint Venture that is the Ultimate Parent Entity of a Covered Group, all profits of that joint-venture will be included in the determination of the Adjusted Profit Before Tax of the Covered Group in which the joint-venture is the Ultimate Parent Entity. To avoid such profits being counted twice for purposes of the Convention, they are therefore excluded from the Adjusted Profit Before Tax of the investors in the Joint Venture.

1093. Subparagraph (a)(iv) provides for the reversal of expenses incurred with respect to illegal payments, which are generally treated as expenses for purposes of financial accounting rules, but which are disallowed as expenses under this Article for reasons of policy.

1094. The concept of 'illegal payments' is intentionally broad in order to cover a wide range of disallowed expenses, including bribes and kickbacks. Legal treatment of certain payments can vary across Jurisdictions, so, to ensure consistency, a payment is considered "illegal" for purposes of the Convention if it is illegal under the laws applicable to the Ultimate Parent Entity, the Group Entity that made the payment or the Group Entity that incurred the expenses. This provision is intended to cover the case where the Ultimate Parent Entity itself does not pay bribes. For example, if the laws applicable to the Ultimate Parent Entity determine that the instruction by the Ultimate Parent Entity for another Group Entity to pay bribes is illegal, the expenses for such payments would fall within subparagraph (a)(iv) even if such payment is not illegal under the laws applicable to the Group Entity that made such payments. This rule would also cover any scenario where the payment is illegal only in the Jurisdiction of the payer Group Entity, and not the Entity that incurred the expense or the UPE (assuming those are all different), as might occur in limited instances where one Group Entity makes payment on behalf of another.

1095. Subparagraph (a)(v) provides for the reversal of expenses for fines or penalties imposed on a Group Entity that equal or exceed EUR 50 000 per occurrence (or in the case of a fine or penalty imposed on a periodic basis until corrective action is taken, in the aggregate within a single Period) for a Group Entity or the equivalent in the functional currency of the Group Entity. For the avoidance of doubt, such fines or penalties would include extra territorial fines imposed by organisations located in a Jurisdiction other than the Jurisdiction where the liable Group Entity is located (e.g. fines or penalties related to competition law). The deduction of fines and penalties imposed by a government is commonly disallowed for tax purposes. The policy rationale for denying a deduction for fines and penalties is to confine their economic cost to the person that committed the act subject to the fine or penalty. This rationale would be diluted if the taxpayer were allowed to share the burden of the penalty with all taxpayers (by way of a tax deduction for it). However, fines and penalties, particularly those for minor offenses such as traffic tickets,

are more frequent than bribes and vary widely in amount. For example, they can range from a EUR 50 traffic ticket incurred by a transportation company to a multi-million EUR fine for securities law violations incurred by a large corporation.

1096. Recognising the de minimis nature of many fines and penalties, the Adjusted Profit Before Tax prohibits deduction only for fines and penalties that each equal or exceed EUR 50 000 (or the equivalent in an Entity's functional currency). However, the disallowance applies also to fines that may be levied in respect of the same activity on a periodic basis (e.g. daily fines) that in the aggregate equal or exceed EUR 50 000 (or the equivalent) in a single period for a specific entity. For a Covered Group that does not use euro as its functional currency, the threshold is applied by reference to the equivalent amount in the functional currency of the Covered Group. A periodic fine or penalty includes a fine or penalty that is assessed periodically until corrective action is taken but does not include separate fines that are for the same type of offense committed upon multiple occasions, such as traffic tickets. The purpose of the threshold is to continue to allow deductions for smaller fines that may not be specifically recorded as separate items in the accounts of the Covered Group. This approach avoids the complexity of tracking small fines and penalties for purposes of the Convention while at the same time preventing Groups from escaping liability because of a few large fines or penalties.

1097. Interest charges for late payment with respect to tax or other liabilities to a government (including liabilities to government agencies and instrumentalities) are not considered fines or penalties for purposes of this provision, and do not need to be added back to Financial Accounting Profit (or Loss).

1098. Subparagraph (b) provides for three additional adjustments. The first adjustment relates to any assets or liabilities that are subject to fair value or impairment accounting, the second adjustment relates to some situations where a Covered Group acquires an equity interest in another Entity, and the third adjustment relates to certain cases of disposition of an asset other than inventory. The policy rationale associated with each adjustment is mentioned below.

1099. Subparagraph (b)(i) provides for the reversal of gains or losses or other impairment with respect to an asset or liability that is attributable to fair value or impairment accounting. Conceptually, the Convention requires that a Covered Group uses the realisation principle for assets and liabilities that are accounted for in a Group Entity's financial accounts using the fair value method or impairment accounting. Subparagraph (b)(i) applies with respect to all assets and liabilities of all Group Entities but does not apply to a Specified Equity Interest of an Entity for which fair value is used, as subparagraph (a)(iii)(B) already expressly requires reversing the inclusion of gain, profit or loss arising from changes in the fair value of a Specified Equity Interest. Under subparagraph (b)(i), gain or loss associated with an asset or liability will arise when the asset or liability is disposed of or liquidated rather than as its value changes due to changes in market value or impairments. The policy justification for this treatment is to reduce volatility by crystallising the gain (or loss) for purposes of the Convention as of the actual date of disposition rather than from one period to the next in line with the accounting treatment. Accordingly, to determine Adjusted Profit Before Tax, under clause (A), a Group Entity must exclude fair value or impairment gain or loss in respect of assets or liabilities from the computation of Adjusted Profit Before Tax and under subparagraph (b)(i)(B), record gains or losses on such assets or liabilities only when realised upon a disposition or liquidation, treating the carrying value of the asset or liability for purposes of calculating that gain or loss as its carrying value at the date the asset was acquired or the liability was incurred less the sum of any depreciation or amortisation that was determined for the asset or liability and included in Financial Accounting Profit (or Loss) of the Covered Group since acquisition. For example, if a Group Entity holds convertible debt in a start-up company and the company performs poorly in its first few years, the Group Entity may be required, under the applicable accounting standard, to recognise a fair value loss on the investment. If the start-up is eventually acquired by an unrelated purchaser and the Group Entity disposes of the convertible debt for its original acquisition cost, the "gain" reported in the consolidated financial

accounts upon the disposition of the convertible debt is not really an economic gain but could be subject to re-allocation under the Convention. Subparagraph (b)(i) prevents this outcome by requiring the Covered Group to determine the gain upon disposition based on the original cost of the asset and to reverse any fair value loss. In instances where a disposed asset was previously subject to depreciation or amortisation charges prior to its classification as an asset accounted on a fair value basis, any such depreciation or amortisation will be deducted from the carrying value to avoid being double counted.

1100. Subparagraph (b)(ii) requires, with respect to assets or liabilities of an Entity in which a Group Entity of a Covered Group acquired on or after the date of entry into effect described in Article 49 an equity interest for total consideration in excess of EUR 10 million such that the acquired Entity became a Group Entity of the same Covered Group, the use of the accounting carrying value of the assets and liabilities that was applicable from the perspective of the acquired Entity immediately before the acquisition for purposes of calculating (a) any depreciation, amortisation or other impairment amount with respect to those assets or liabilities, and (b) calculating any gain or loss in the event of the disposition of those assets or liabilities by a Group Entity after deducting any depreciation, amortisation or other impairment amount determined under subparagraph (a). In other words, the Covered Group inherits the carrying value that the underlying acquired assets and liabilities had in the hands of the acquired Entity as at the date of acquisition. In determining whether the consideration paid to acquire the relevant equity interest exceeds the EUR 10 million threshold the cumulative total consideration paid in respect of the Covered Group's equity interest in the Entity is considered where this has been acquired over multiple transactions. For example, if a Group Entity of the Covered Group acquired an initial non-controlling interest for consideration of EUR 6 million in Period 1 and the same or another Group Entity subsequently acquired a further interest for EUR 6 million in Period 2 that led to the Covered Group gaining a controlling interest in the investee the total consideration taken into account in determining that the EUR 10 million threshold has been met would be the sum of the two payments (i.e., EUR 12 million). Where a Group Entity of a Covered Group acquires an initial non-controlling interest then disposes part of that interest and then obtains a further interest resulting in the Covered Group gaining control of the investee the relevant total consideration would be equal to the sum of the two payments to acquire equity interests less the consideration received for disposition of the equity interests. If the Covered Group disposes of the assets and liabilities, any gain or loss on disposition of such assets would also be determined based on the carrying value of the assets and liabilities that was applicable from the perspective of the acquired Entity as at the date of acquisition, after deducting any depreciation, amortisation or other impairment amount determined as described above. The policy rationale for this adjustment is to ensure that any difference in the treatment of gains or losses from the transfer of asset and equity under the Convention does not lead to a permanent and unjustified reduction of the amount available for reallocation under the Convention. Given that gains and losses on dispositions of equity interests are excluded from the Adjusted Profit Before Tax of the disposing entity whereas the gains and losses on dispositions of assets are included, it is important to ensure that any step up in basis is not recognised by the acquirer in the case of an equity acquisition to ensure no erosion of the Adjusted Profit Before Tax. With respect to this adjustment, and the subsequent adjustment included in subparagraph (b)(iii), the reason for introducing this materiality threshold is to ensure that unnecessary administrative burden is not imposed on Covered Groups to perform these adjustments where the impact would be relatively minor. Where the materiality threshold is not satisfied, no adjustment would be performed to the Adjusted Profit Before Tax of the Covered Group with respect to the income or expense that would otherwise be subject to this adjustment.

1101. Subparagraph (b)(iii) provides for the spreading over five periods of gain or loss from dispositions that occur on or after the date of entry into effect described in Article 49 of assets other than inventory that result in a gain or loss from the disposal that exceeds EUR 10 million. Accordingly, subparagraph (b)(iii) allocates such gain or loss recognised upon the disposition evenly among the Period in which the disposition occurs and each of the four subsequent periods. This adjustment corresponds to an adjustment in the Elimination Profit (or Loss) that addresses scenarios where the disposition of an asset would

otherwise result in an abnormally high or low Return on Depreciation and Payroll in the period in which the disposition occurs. Incorporating this adjustment in the Adjusted Profit Before Tax avoids temporal misalignment with the Elimination Profit (or Loss), however it should be noted that the materiality threshold applied for the two tax bases are not identical.

1102. Subparagraph (c) provides for the “prior period adjustment” to the Financial Accounting Profit (or Loss) of the Covered Group for a Period in order to calculate Adjusted Profit Before Tax for that Period. This adjustment is defined in paragraph 2 and further explanation is provided in paragraph 1105 of this Explanatory Statement.

1103. Subparagraph (d) provides for the exclusion of the Entity Financial Accounting Profit (or Loss) for each Entity that is an Excluded Entity, which will either increase or decrease the Financial Accounting Profit (or Loss) of the Covered Group. The term “Excluded Entity” is defined in Article 2(q) and refers to an Entity that is specifically excluded from the scope of the Convention. Generally, the assets, liabilities, income, expenses and cash flows of such Entities would not be consolidated on a line-by-line basis with other Entities under an Acceptable Financial Accounting Standard (this means that the adjustment in subparagraph (d) will rarely occur for most Groups; see also paragraph 87 of the Explanatory Statement. However, the financial results of an Excluded Entity may be included in the Consolidated Financial Statements of a Covered Group in a limited number of instances where the Excluded Entity reports third party revenues. In practice, this is only expected to be the case where an *investment fund*, or a *real estate investment vehicle*, is an Ultimate Parent Entity because it owns a Controlling Interest in other Entities. In such case the Ultimate Parent Entity, and other Entities in which it owns a Controlling Interest (depending on whether they meet the relevant conditions in Article 2(h)), is an Excluded Entity. Instances of an Excluded Entity that is consolidated by an Ultimate Parent Entity that is not an Excluded Entity itself are expected to be very rare and, if they occur, the adjustment in subparagraph (d) would likely have limited impact (for example, where a *non-profit organisation* or *pension fund* is consolidated). However, to ensure consistency in such limited circumstances, where the financial results of an Excluded Entity are consolidated, subparagraph (d) explicitly excludes Entity Financial Accounting Profit (or Loss) of Excluded Entities to the extent the profit or loss of such an Entity are included in Financial Accounting Profit (or Loss) of a Group. In other words, subparagraph (d) serves as a backstop to ensure that profits of Excluded Entities are not included in the Adjusted Profit Before Tax. The term Entity Financial Accounting Profit (or Loss) is defined in Article 2(p). In cases where the Financial Accounting Profit (or Loss) of the Excluded Entity includes income or expenses that relate to transactions or arrangements between the Excluded Entity and other Group Entities, such transactions or arrangements must be accounted for in accordance with the existing allocation of taxing rights to define Financial Accounting Profit (or Loss) attributable to the Excluded Entity and profits attributable to the other Group Entities that are involved in those transactions or arrangements.

1104. Subparagraph (e) provides for the deduction of “relevant net losses” in accordance with paragraph 3 (see discussion of paragraph 3 below). It establishes an ordering principle whereby *relevant net losses* (comprising both *eligible net losses* and *transferred losses*, if any) must be deducted in the chronological order of the prior Period(s) to which the losses correspond (i.e. ‘first-in, first-out’). Subparagraph (e) also confirms that *relevant net losses* are deducted in a Period only to up to the amount of the Financial Accounting Profit in the Period, after making the adjustments described in subparagraphs (a) through (d).

Paragraph 2

Prior period adjustment

1105. Paragraph 2 defines the term “prior period adjustment”. The *prior period adjustment* means an adjustment corresponding to all changes in the opening equity of the Period that relate to a correction of

an error in the determination of the Financial Accounting Profit (or Loss) or a change in an accounting principle or policy and are attributable to transactions or other events that would have impacted the determination of Adjusted Profit Before Tax for (i) a prior Period when the Covered Group was a Covered Group or (ii) a prior Period that would be an *eligible prior period* but for the requirement that there be an *unused loss* with respect to that prior Period, had they initially been recorded in the prior Period on the same basis as that reflected in the relevant changes in the opening equity of the Period.

1106. In general, when a Covered Group corrects an error in the determination of Financial Accounting Profit (or Loss) in a previous Period, it may be required to prepare restated Consolidated Financial Statements for the Period to which the error related. Pursuant to paragraph 2, a Covered Group may also need to re-determine its opening equity (i.e. the equity at the beginning of the Period) in the Period in which the error was discovered or as soon as practicable. The adjustments may increase or decrease the opening equity depending upon the nature of the error. For example, an erroneous exclusion of revenue in a previous Period will generally result in an increase to opening equity and a corresponding increase to income in the computation of the Adjusted Profit Before Tax in the Period when the error is corrected.

1107. Similarly, when a Covered Group changes an accounting principle or policy used in the determination of its Financial Accounting Profit (or Loss), it may be required to re-determine its opening equity as if it had used the new accounting principle or policy in previous Periods. The change in accounting principle or policy may require either an increase or decrease in the opening equity, as an increase or decrease in opening equity represents the net income, gain, expense, or loss that, under the new accounting principle or policy, would have been included in that computation in a previous Period. The effect of the adjustment under paragraph 2 should correspond to the adjustment to opening equity. Thus, if a change in accounting principle or policy decreases opening equity, the *prior period adjustment* would be a negative adjustment that has the same effect as an additional deduction in the computation of Adjusted Profit Before Tax. Conversely, if a change in accounting principle or policy increases opening equity, the *prior period adjustment* would be a positive adjustment that has the same effect as an additional item of income in the computation of Adjusted Profit Before Tax.

1108. Subparagraph (c) contains rules requiring the prospective spreading of the *prior period adjustment* where a materiality threshold is met. If the *prior period adjustment* for the Covered Group in the Period exceeds EUR 10 million, the adjustment is spread pro rata over the current Period plus the greater of the two subsequent Periods; or the number of subsequent Periods equal to the number of Periods to which the *prior period adjustment* in the Period relates minus one. If the *prior period adjustment* for the Covered Group in the Period is less than EUR 10 million the total amount is included in the Covered Group's Adjusted Profit Before Tax in the Period in which the triggering event occurs.

1109. To the extent that an error or a change in an accounting principle or policy is attributable to a Period that is prior to the application of the Convention to the Covered Group and that is not a Period that would be an *eligible prior period* and would also not be an *eligible prior period* if the requirement that an *unused loss* must be observed with respect to that prior Period were removed, the adjustment to opening equity does not result in a *prior period adjustment* under paragraph 2. By defining the relevant Periods for which prior period adjustments will be considered in this way, it is ensured that the Period taken into account for prior period adjustments is aligned with that same Period that losses might be carried forward. By adapting the definition of *eligible prior period* to not include the element of *unused losses*, the treatment of *prior period adjustments* will be neutral among circumstances where *unused losses* do or do not exist. Further, this adjustment will apply equally with respect to both upward and downward *prior period adjustments*.

1110. In addition, the *prior period adjustment* applies only to items of income or expenses that were, or would have been, included in the computation of the Adjusted Profit Before Tax. In such cases, it must be

treated as an increase or decrease to the Financial Accounting Profit (or Loss) of the Covered Group. Otherwise, items of income or expenses that were not, or would not have been, included in the computation of the Adjusted Profit Before Tax should not be taken into account for the purpose of the *prior period adjustment*.

Paragraph 3

Relevant net losses

1111. The definition of Adjusted Profit Before Tax in paragraph 1(e) provides for the deduction of “relevant net losses”, which are defined in paragraph 3 to include: (a) the “eligible net losses” of the Covered Group; and (b) any “transferred losses” available pursuant to an “eligible business combination” or an “eligible division”, if elected by the Covered Group and provided a business continuity requirement is met. Where a *disclosed segment* of the Covered Group was a *covered segment* in a prior Period, certain amounts are disregarded pursuant to paragraph 3(c) to prevent double counting in the computation of *relevant net losses*.

1112. Paragraph 3, in combination with paragraph 1(e) provides that the “eligible net losses” and any “transferred losses” described in paragraph 4. are deducted as “relevant net losses” in the chronological order of the prior Period(s) to which such “eligible net losses” and “transferred losses” correspond. This mechanism follows a “first-in, first out” approach to the utilisation of losses. Under this mechanism, *relevant net losses* are not calculated for and allocated to a specific market jurisdiction, nor attributed to specific Group Entities of the Covered Group, but instead are calculated and reported through a single account at the level of the Covered Group. This means that *relevant net losses* must be reported and administered separately from any existing domestic loss carry-forward regime applicable to the Covered Group and its Group Entities (for documentation and reporting obligations, see Part V Section 1 (Administration)).

1113. Paragraph 5(a) defines the term “eligible net losses”. The calculation of *eligible net losses* requires a retrospective computation starting from the Financial Accounting Profit (or Loss) of each *eligible prior period* and making the adjustments described in paragraph 1(a) through (d), as well as any other adjustment necessary to ensure that the *eligible net losses* are deducted in the chronological order of the prior period(s) to which they correspond. *Eligible net losses* will exist to the extent that, after making those adjustments for each *eligible prior period*, the total amount of cumulative financial accounting losses exceeds the total amount of cumulative Financial Accounting Profits over the *eligible prior periods*. The reference to the adjustments listed in paragraphs 1(a) through (d) means that, to achieve consistency, the same tax base rules apply to calculate the profit or loss of the current Period and that of any *eligible prior period*. Pursuant to paragraph 5(a), the same rules apply for the purpose of calculating the amount of losses of a separate Group or Entity that can be transferred to the Covered Group (“transferred losses”).

1114. Paragraph 5(b) defines the term “eligible prior period” to include each Period: (1) starting with the earliest Period, if any, that falls within specified time limits and in which, after making the adjustments set out in paragraph 1(a) through (d), there is an *unused loss* (irrespective of whether the Group was a Covered Group during that earlier Period), and (2) ending with the Period immediately preceding the current Period. This rule ensures that any prior Period(s) following the first loss-making Period is automatically treated as an *eligible prior period*, regardless of whether such a prior period was profit- or loss-making. The consequence is that any Financial Accounting Profit (or Loss) reported by the Covered Group after that first loss Period is taken into consideration for the calculation of the amount of *eligible net losses* that is deductible from the profit of a Period.

1115. Paragraph 5(h) defines the term “unused loss” as a Financial Accounting Loss of a Period that has not been offset by Financial Accounting Profit of a subsequent Period, after making the adjustments under

paragraph 1(a) through (d) in each Period (and disregarding any amount described in paragraph 3(c), to prevent double-counting if a *disclosed segment* was a *covered segment* in a prior period), in accordance with the rules of paragraph 1(e). An “unused loss” is therefore an amount that may give rise to a “relevant net loss”, deductible in the current Period.

1116. Relevant net losses are deducted only up to the amount of the Financial Accounting Profit, if any, for the current Period, after making the adjustments under paragraph 1(a) through (d). This means that any excess amount of *relevant net losses* must be carried forward to the subsequent Period, and potentially be deducted in that Period if the other conditions in paragraph 3 are met for that Period (e.g. time limitations related to *eligible prior periods*). The deduction and carry-forward of *relevant net losses* (including *relevant net losses* that are constituted by *transferred losses*, where an election has been lodged pursuant to paragraph 3(b)) is mandatory for the Covered Group, as this rule has an impact on the amount of profit subject to reallocation under Article 5.

1117. Where a Covered Group falls out of scope in a Period and then comes into scope again under Article 3 in a subsequent Period, the mechanism described above to compute, deduct and carry-forward *relevant net losses* continues to apply unchanged. This means that any Financial Accounting Profits (or Losses) (as adjusted under paragraph 1(a) through (d)) of a Group from the intervening Period(s), as well as any *transferred losses*, are included in the calculation of *relevant net losses* available for deduction in any subsequent Period where the Covered Group is in scope. There is no difference in treatment between *relevant net losses* that are incurred by a Group before or after it first falls into scope under Article 3.

1118. Where losses were incurred in more than one earlier Period, adjustments may be necessary pursuant to the chronological ordering principle in paragraph 1(e) to ensure that the *unused losses* from the earliest Period are deducted first against subsequent profits (i.e. in chronological order). Where a balance of *relevant net losses* is available for deduction and carried forward over several Periods by the Covered Group, such adjustments would also ensure that the profits from an earlier Period are not taken into consideration multiple times to offset prior losses under paragraph 3 (for an illustration, see Example 2 below). In practice, this means that where a Covered Group deducts *relevant net losses* in a Period, but does not have sufficient Financial Accounting Profit (after adjustments) to absorb the entire balance of *relevant net losses* in that Period, the earliest *unused losses* must be deducted first. The excess amount of *relevant net losses* is carried forward and deducted in a subsequent Period to the extent that the relevant time limitations are satisfied (see definition of “eligible prior period” in paragraph 5(b)).

1119. The loss carry-forward rules contained in paragraph 3 will be relevant for a Covered Group: (i) in the first Period the Covered Group falls in scope under Article 3], if it has *unused losses* from *eligible prior periods* (and potentially the subsequent Periods until such *unused losses* are either entirely offset by subsequent Financial Accounting Profit, or no longer available for carry-forward); (ii) following any later Period where there is a Financial Accounting Loss, as adjusted under paragraph 1(a) through (d); and (iii) subject to an election by the Covered Group pursuant to paragraph 3(b), following any business combination or division that gives rise to “transferred losses” in accordance with paragraph 4.

1120. The application of the loss carry-forward rules in a given Period may either (i) have no effect on the Adjusted Profit Before Tax (i.e. where there are no *relevant net losses* available); (ii) reduce the amount available for reallocation under Article 5 (i.e. where, after deduction of the *relevant net losses*, the Adjusted Profit Before Tax of the Covered Group remains above the profitability threshold under Article 3; or (iii) prevent the reallocation of any profit under the Convention (i.e. where, after deduction of the *relevant net losses*, the Adjusted Profit Before Tax of the Covered Group falls below the profitability threshold under Article 3). In the latter scenario, as the Covered Group is in scope in the current Period (having satisfied the relevant threshold tests in Article 3), it must comply with the relevant filing and other administrative

obligations to demonstrate that it does not have any profit available for reallocation in that period under Article 5.

Box 20. Examples – Relevant net losses

Example 1 – Application of the deduction of relevant net losses and profitability test

In Example 1, the Group is profitable in all periods within the applicable time limitations for loss carry-forward, except for P-1 where it incurred a Financial Accounting Loss, after making the adjustments under paragraph 1(a) through (d). The Group has consistently earned revenues above the revenue test threshold, and began to earn profits above the profitability test threshold in P-3. Despite significant profits in P-2, the Group meets all scope threshold requirements for the first time only in the current Period, becoming a Covered Group. In addition to satisfying the revenue test and the profitability test in the current Period, the Group satisfies the prior period test (having a *pre-tax profit margin* greater than 10 per cent in both P-3 and P-2) and the average test (having an average *pre-tax profit margin*, from P-4 through the current period, greater than 10 per cent). (See Article 3 for further detail on the relevant threshold tests.)

To determine the Covered Group's Adjusted Profit Before Tax in the current Period, it must make all of the adjustments under of Annex B Section 2(1)(a) through (d) and deduct pursuant to paragraph 1(e) any "relevant net losses" that may be available for carry-forward.

To determine whether any *relevant net losses* are available for deduction:

- The Covered Group must first identify whether any prior Period qualifies as an "eligible prior period" – i.e. whether there is any prior period within the applicable time limitations with an *unused loss*. This takes into account the adjustments under paragraph 1(a) through (d) for each prior period. Under the facts of Example 1, the only prior Period with a Financial Accounting Loss (after adjustments) is P-1, which is within the applicable time limitations. As the loss in P-1 has not been offset by subsequent profits; the full amount of this loss is therefore an "unused loss", and P-1 is the sole "eligible prior period" of the Covered Group.
- To determine the balance of "eligible net losses" under paragraph 3(a) to carry forward in the current period, the profits and losses of all *eligible prior periods* must be netted. As P-1 is the only *eligible prior period*, the full amount of losses incurred in that Period (EUR 630 million) is available for carry-forward as "relevant net losses" in the current Period.
- The Covered Group does not make any election to deduct *transferred losses* in the Period under paragraph 3(b).
- The *relevant net losses* carried forward in the current period (EUR 630 million) are deducted in the computation of the Covered Group's Adjusted Profit Before Tax. Since the *relevant net losses* are fully absorbed by the Financial Accounting Profit in the current Period, there will be no "unused loss" to carry forward to subsequent Periods.

After deduction of *relevant net losses*, and having made all of the adjustments under paragraph 1(a) through (d), the Covered Group's "Adjusted Profit Before Tax" in the current period is EUR 2,87 billion.

(EUR'000,000 unless specified)	P-5	P-4	P-3	P-2	P-1	Current Period
Adjusted Revenues	20,500	21,000	22,000	24,000	21,000	25,000
Financial Accounting Profit (or Loss) after adjustments	615	1,890	2,820	3,840	(630)	3,500
Pre-Tax Profit Margin (%) in the Period	3	9	13	16	-3	14
Relevant net losses carried forward from earlier Periods	-	-	-	-	-	630
Adjusted Profit Before Tax	-	-	-	-	-	2,870
Excess relevant net losses carried forward to subsequent Period	-	-	-	-	-	0

Example 2 – Adjustment to ensure relevant net losses are deducted in chronological order

In Example 2, the Group incurred very significant losses associated with its start-up costs in P-11 and P-10, and turned profitable as of P-9. The Group began to earn profits above the profitability test threshold in P-5, and revenues above the global revenue test threshold in P-3. Despite significant revenues and profits in P-3 and P-2, the Group met all scope threshold requirements for the first time only in P-1, becoming a Covered Group. In addition to satisfying the revenue test and the period test in P-1, the Group satisfies the prior period test (having a *pre-tax profit margin* greater than 10 per cent in P 5 through P-2) and the average test (having an average *pre-tax profit margin* in P-5 through to P-1, greater than 10 per cent). As the averaging mechanism only looks to current Period and the four Periods immediately preceding a particular Period, the Financial Accounting Profits and losses from P-6 and earlier Periods (including the losses incurred in P-11 and P-10) are not taken into account for scoping purposes in P-1. The Group continues to meet the scope tests in the current Period (P), and thus remains a Covered Group.

To determine the Covered Group's Adjusted Profit Before Tax in P-1, it must make all of the adjustments under paragraph 1(a) through (d), and deduct any "relevant net losses" that may be available for carry forward.

To determine whether any *relevant net losses* are available for deduction in P-1:

- The Covered Group has *unused losses* in periods P-11 and P-10, which are both within the applicable time limitations for P-1. The prior Periods from P-11 to P-2 are therefore "eligible prior periods" of the Covered Group in P-1.
- The "eligible net losses" available for deduction under paragraph 3(a) in P-1 are equal to the amount by which the cumulative Financial Accounting Losses (after adjustments) from P-11 and P-10 exceed the cumulative Financial Accounting Profits (after adjustments) from P-9 through P-2 ((10+10) – (0.5+1+1+1+1.5+2+3+3) = EUR 7 billion).

Business continuity requirement

1121. A Covered Group may only deduct an amount of *transferred losses* arising from an *eligible business combination* or *eligible division* under paragraph 3(b) as “relevant net losses” if the business continuity requirement is met. This business continuity requirement applies to each *eligible business combination* or *eligible division* separately. It comprises two cumulative conditions – one retrospective and one prospective, as from the time of the *eligible business combination* or *eligible division*. In order to recognise *transferred losses* from such an *eligible business combination* or *eligible division*, the Covered Group must demonstrate that both tests are satisfied.

1122. This business continuity requirement is intended to prevent loss trafficking. For example, the requirement would prevent the transfer of losses where a Covered Group acquires a Group that no longer carries on any business activity, solely for the purpose of utilising its unrelieved losses; or, where a Covered Group acquires a Group with unrelieved losses only to immediately terminate that Group’s business activity post-acquisition. The business continuity requirement seeks to ensure a degree of continuity between the economic identity of the underlying business that generated the *transferred losses* and the business being carried on at the time such *transferred losses* are deducted by the Covered Group. That said, it does not purport to specifically trace the business activities to which a particular loss may relate. It applies at the level of a Group generally, and only with respect to the 12-month period preceding the business transfer and the 24-month period that follows.

1123. Under the business continuity requirement: (i) the *transferred entity or group* or the part of the *predecessor group* that was transferred to the Covered Group must carry on the same or similar business(es) as it did immediately before the *eligible business combination* or *eligible division* throughout the 12-month period immediately preceding the *eligible business combination* or *eligible division*; and (ii) the Covered Group must carry on the same or similar business(es) as the *transferred entity or group* or the part of the *predecessor group* that was transferred to the Covered Group throughout the 24-month period following the *eligible business combination* or *eligible division*.

1124. In the case of an *eligible division*, the part of the *predecessor group* that is relevant for the purpose of applying this requirement is the part of the *predecessor group* transferred to the Covered Group. This means the business continuity requirement will not extend to an activity of the *predecessor group* that is transferred to a Group other than the Covered Group following the *eligible division*.

1125. The business continuity requirement is not intended to apply at a granular level. Instead, the overall nature or identity of the transferred business activities must be considered, in light of all relevant facts and circumstances, to determine whether a “same or similar business” is being carried on. The term “business” generally designates the integrated set of activities (i.e. processes, actions) and assets capable of being conducted and managed for the purpose of providing goods or services to customers and generating income. The notion of “same or similar” is intended to be broad and to capture changes that, although they may be significant, do not alter the core nature of the underlying business activities. In such circumstances, the conditions of the business continuity requirement would be met. For example, following an *eligible business combination* or *eligible division*, it is normal for certain changes to be made as part of the integration of the relevant business within the new structure of the Covered Group. Often these changes may relate to the creation of synergies, the centralisation of certain business functions at the level of the head office or at other levels of the Covered Group, the expansion into new markets, the adoption of new technologies or be part of normal organic expansion and growth strategy following the integration. The conditions of the business continuity requirement are only intended to capture instances where the changes are significant and effectively result in the cessation of the initial business.

1126. Several factors will be of particular relevance in applying the business continuity requirement and could indicate that a “same or similar business” is being carried out:

- **Assets.** Whether there has been a significant change in the asset base of the transferred group, entity or relevant part of the *predecessor group*. In particular, the focus should be on whether the assets that previously drove the economic returns of the business are being used in the same way. This includes both tangible assets (e.g. plant and machinery) and intangible assets (e.g. intellectual property), whether or not recognised on the balance sheet of the Covered Group. The normal replacement or upgrade of assets in the ordinary course of the business would not be considered a significant change. Further, where assets are disposed of, or otherwise no longer used in the ordinary course of the business (e.g. as a result of synergies or streamlining or other similar strategies commonly pursued following an *eligible business combination* or *eligible division*), this would not constitute a significant change. Instead, a significant change should be understood as a wholesale change in the way the Covered Group uses and exploits its assets to generate value.
- **Employees.** The number or composition of employees of the business does not significantly change over the relevant period, for instance, as a result of wholesale redundancies that follow the termination of certain business lines or abandonment of certain markets. However, where the number or composition of the employees of the business is streamlined or redeployed to tailor workforce allocation to the new circumstances and drive value following the *eligible business combination* or *eligible division* (as may be expected), this would not constitute a significant change.
- **Goods or services produced.** The type of core goods and/or services provided to third party customers remains broadly the same or similar over the relevant period. This could be demonstrated through an examination of the Consolidated Financial Statements of the Group, which will ordinarily disclose a significant change in the goods or services provided by the Group under the relevant Acceptable Financial Accounting Standard. Further, additional publicly available information, such as industry classification codes (e.g. SIC or NACE codes), investor relations presentations or other materials, could provide information on relevant changes to the Group’s core goods and/or services offerings.
- **Revenues.** The revenues generated by the business from the supply of core goods and services to third party customers do not significantly decrease over the relevant period as a result of decisions taken by the business to change the way that the group earns revenues after the *eligible business combination* or *eligible division*. Where revenues significantly decrease as a result of factors outside the control of the business, for instance, as a result of a general downturn, this would not be an indicator of a significant change for purposes of the business continuity requirement.
- **Business processes.** The processes through which the business activities are carried on and the means through which the business interacts with and delivers its goods and services to the customer base (e.g. production methods, sales strategies) are not changed in a significant way. Strategic and operational improvements that do not impact the underlying business processes but contribute to generating economic returns in the ordinary course of the business (e.g. adopting new technologies to supply goods or services more effectively) would not be considered a significant change.

1127. Moreover, temporary suspensions of activities for legitimate business reasons (e.g. to adapt to new regulatory requirements) would not cause a Covered Group to fail the business continuity requirement.

1128. The factors listed above are indicative in nature and must be assessed in light of all relevant facts and circumstances.

Rule to prevent double-counting where a disclosed segment was a covered segment in a prior period

1129. Paragraph 3(c) provides a transitional rule for cases where a Group becomes a Covered Group after one of its *disclosed segments* was a *covered segment*. This rule is intended to prevent the double-counting of profits and losses at the group and segment levels. The reverse scenario (i.e. where a *disclosed segment* comes into scope of the Convention after the Group reporting that *disclosed segment* was a Covered Group) is addressed as part of the definitions of “segment relevant net losses” and “segment eligible prior period” in Annex C Section 4(8)(f) and (i), respectively.

1130. The rule effectively excludes the profits and losses of the concerned *disclosed segment*, over relevant prior Periods, in the computation of the Covered Group’s *relevant net losses*. The rule applies regardless of whether the Group continues to report the same *disclosed segment* in the current Period. This rule avoids double-counting by ensuring that the *disclosed segment’s* results are disregarded in respect of any prior Period where those same results were already taken into account under the Convention in computing that *disclosed segment’s segment adjusted profit before tax* (either because it was a *covered segment* in the prior Period, or because the *disclosed segment’s* profit or loss in the prior Period was taken into account in calculating the *segment relevant net losses* carried forward and deducted under the Convention).

1131. Paragraph 3(c)(i) provides that the *segment financial accounting profit (or loss)*, after making the relevant adjustments under Annex C Section 4(8)(d)(i) and (ii), of the *disclosed segment* is disregarded in respect of (A) any Period in which the *disclosed segment* was a *covered segment*, and (B) any Period that was a *segment eligible prior period* of that *disclosed segment*.

1132. Paragraph 3(c)(ii) provides that any amount of *segment transferred losses* attributable to the concerned *disclosed segment* is also disregarded in computing the amount of *relevant net losses* of the Covered Group. Any amount of *transferred losses* arising from an *eligible business combination* or *eligible division* that has not been attributed to the *disclosed segment* pursuant to Annex C Section 4 remains available for deduction by the Covered Group pursuant to Annex B Section 2(3)(b).

1133. The precise amounts described in paragraph 3(c) will already have been calculated and reported pursuant to the provisions of Annex C Section 4 in the prior Period(s) where the *disclosed segment* was a *covered segment*.

Box 21. Example – Interaction between group- and disclosed segment- level losses (Group reporting the covered segment was previously a Covered Group)

This example makes reference to the Financial Accounting Profit of Group X (after making the relevant adjustments under Annex B Section 2(1)(a) through (d)) and the *segment financial accounting profit* of Segment C (after making the relevant adjustments in subdivisions (i) and (ii) of the definition of “segment adjusted profit before tax”). These figures are reflected in the table further below.

The facts of this example build upon those provided in the example in Box 32(Interaction between *disclosed segment-* and group-level losses (Group reporting the *covered segment* was previously a Covered Group)) in the Explanatory Statement on Annex C Section 4(8)). In summary, in that example:

- Group X was a Covered Group for the first time in P-2. It carried forward *unused losses* incurred in P-3. Group X had not incurred any prior to P-3; P-3 was the sole *eligible prior period* of Group X.
- *Disclosed segment C*, a *disclosed segment* reported by Group X, became a *covered segment* for the first time in P. It carried forward *segment unused losses* incurred in *disclosed segment C* in P-4. P-4 and P-1 were the two *segment eligible prior periods* of *disclosed segment C*.
- No other *disclosed segment* of Group X has ever been a *covered segment*.
- No election has been made to recognise any *transferred losses* or *segment transferred losses*.

In P+1, *disclosed segment C* is again a *covered segment*. It did not have any *segment relevant net losses* to carry forward and deduct (including any *segment transferred losses*).

In P+2, Group X comes into scope for the second time. The Financial Accounting Profit of Group X in P+2, after making the relevant adjustments under Annex B Section 2, is EUR 2.5 billion. To compute the Adjusted profit before tax, any *relevant net losses* (comprising both *eligible net losses* and *transferred losses*, if any) are carried forward and deducted from that amount.

(The Financial Accounting Losses incurred by Group X in P-3 were fully offset by the financial accounting profit of Group X in P-2, after making the relevant adjustments in each period (see example in Box 32, referred to above). As a result, the losses incurred in P-3 are no longer considered to be unused losses. The analysis below thus focuses only on subsequent periods.)

To avoid double-counting in calculating the *relevant net losses* for Group X in P+2, Group X must disregard the following amounts: (i) the *segment financial accounting profit (or loss)* (after making the relevant adjustments) of *disclosed segment C* in any Period in which *disclosed segment C* was a *covered segment* (P, P+1) and any Period that was a *segment eligible prior period* of *disclosed segment C* (P-1, P-4); and (ii) any amount of *segment transferred losses* attributable to *disclosed segment C* (nil).

- *Eligible net losses* of Group X are determined by reference to its *eligible prior periods*, if any, which requires the identification of the earliest Period with an *unused loss*. (As explained above, Group X has no *unused losses* in P-2 or earlier Periods, so the analysis below focuses only on periods after P-2.) Under the rule to avoid double-counting, this exercise must be carried out by disregarding the relevant amounts, such that:
 - In **P-1** (an *eligible prior period* of *disclosed segment C*): the (*adjusted*) *segment financial accounting profit* of *disclosed segment C* is removed from the (*adjusted*) *financial accounting profit* of Group X for that Period (EUR 1,650 million – EUR 100 million = **EUR 1,550 million**).
 - In **P** (a Period in which *disclosed segment C* was a *covered segment*): the (*adjusted*) *segment financial accounting profit* of *disclosed segment C* is removed from the (*adjusted*) *financial accounting profit* of Group X for that Period (EUR 1,950 million – EUR 2,050 million = **EUR (-100) million**).
 - In **P+1** (a Period in which *disclosed segment C* was a *covered segment*): the (*adjusted*) *segment financial accounting profit* of *disclosed segment C* is removed from the (*adjusted*) *Financial Accounting Loss* of Group X for that Period (EUR 1,750 million – EUR 3,050 million = **EUR (-1,300) million**).
- On the basis of the revised amounts described above, P and P+1 are identified as the *eligible prior periods* of Group X (i.e. the earliest prior Period within applicable time limitations with an *unused loss*, and any subsequent Period between that Period and the current Period). The *eligible net losses* of Group X in P+2 are therefore equal to EUR 1,400 million (EUR 100 million [P] + EUR 1,300 million [P+1]), i.e. the total amount of cumulative *segment financial accounting*

losses that exceed the total amount of cumulative *segment financial accounting profits* over the *segment eligible prior periods*, after making relevant adjustments in each Period, and after excluding the amounts previously taken into account in computing the *segment adjusted profit before tax* of *disclosed segment C* under the Convention.

- No election is made to recognise any *transferred losses*.
- In computing its Adjusted Profit Before Tax for P+2, Group X carries forward and deducts *relevant net losses* of EUR 1,400 million (such that its Adjusted Profit Before Tax for P+2 is equal to EUR 1,100 million). These *relevant net losses* are constituted by losses arising in P and P+1, disregarding any profit earned in those Periods in *disclosed segment C* (because those profits have already been taken into account, for purposes of the Convention, in computing the *segment adjusted profit before tax* of *disclosed segment C* in P and P+1).

Adjusted group or segment financial accounting profit (or loss), in EUR million

	P-2	P-1	P	P+1	P+2
Group X [disregarding Disclosed segment C]	2100	1650 [1550]	1950 [-100]	1750 [-1300]	2500
Disclosed segment A	550	1200	100	-600	300
Disclosed segment B	600	350	-200	-700	200
Disclosed segment C	950	100	2050	3050	2000

Paragraph 4

Transferred losses

1134. The rules on *transferred losses* allow the Covered Group, in certain circumstances, to elect to deduct unrelieved losses that were not reported in its Consolidated Financial Statements and that relate to a business that has since become a part of the Covered Group. Paragraph 4 sets out the general rules to calculate the amount of *transferred losses* that a Covered Group may elect to deduct pursuant to paragraph 3(b). Such *transferred losses* may be deducted as part of the Covered Group's *relevant net losses* in the calculation of its adjusted profit before tax in the Period. Pursuant to paragraph 1(e), *transferred losses* are deducted as *relevant net losses* in the chronological order of the prior Period(s) to which such *transferred losses* correspond and are carried forward accordingly (subject to the time limitations provided under paragraph 3(b).).

1135. The deduction of *transferred losses* is optional; the Covered Group may make an election in this respect for each relevant *eligible business combination* or *eligible division*. Such an election is made only once in respect of a particular business combination or division. Paragraph 3(b)(iii). requires that the election be lodged in the first Period ending after the relevant *eligible business combination* or *eligible division* in which the Covered Group is a Covered Group. This election would also cover, as applicable,

any prior transactions that may result in the *transfer of losses* to the transferred business (i.e. ‘successive transfers’, see paragraph 1144 below). This rule is intended to ensure consistency in the treatment of *eligible net losses* and *transferred losses*, and in the application of the chronological ordering principle set out in paragraph 1.e.

1136. Paragraph 4 sets out the rules to calculate the amount of *transferred losses*, if any, arising from an *eligible business combination* or an *eligible division*. These rules refer to those set out under paragraph 3 for the calculation a Covered Group’s *relevant net losses*, adapted where necessary to apply to a *transferred entity or group*, or a *predecessor group*.

Eligible business combinations

1137. Paragraph 4(a) covers an “eligible business combination”, which broadly comprises operations where the Covered Group acquires an entire group (a “transferred group”) or an entity that was not a Group Entity of another Group (a “transferred entity”). More precisely, “eligible business combination” is defined in paragraph 5(e) to mean a transaction or arrangement that is reported as a business combination in the Consolidated Financial Statements of a Covered Group, and in which: (i) an Entity that was not a Group Entity of another Group at the time of the transaction or arrangement is transferred, such that it becomes a Group Entity of a Covered Group; or (ii) all or substantially all the assets and liabilities of another Group are transferred such that each of the transferred Group Entities of that other Group becomes a Group Entity of the Covered Group, and any non-transferred part of that other Group is not a Group separate from the Covered Group following the transaction or arrangement. The “transferred entity” or “transferred group” is the Entity or Group that is transferred to the Covered Group in the *eligible business combination*. The threshold of “all or substantially all” in paragraph 5(e)(ii) would be satisfied where at least e.g. 90 per cent of the assets and liabilities of the other Group is transferred to the Covered Group as a result of the business combination.

1138. The transaction or arrangement must first constitute a business combination under the relevant Acceptable Financial Accounting Standard to qualify as an *eligible business combination*. It is the treatment under the Acceptable Financial Accounting Standard that is determinative in this respect. The term “business combination” is commonly used across different Acceptable Financial Accounting Standards and is a broad term that includes a transaction or other event in which an acquirer obtains control of one or more businesses. This includes transactions sometimes colloquially referred to as “true mergers” or “mergers of equals”.

1139. Where not all of the assets and liabilities of the other Group are transferred to the Covered Group in the business combination, the non-transferred part of the other Group must not continue to exist as a separate Group after the business combination in order to qualify as an *eligible business combination*. This condition will be satisfied, for example, in the following situations:

- the non-transferred part of the other Group is liquidated as a result of the business combination (or shortly after the business combination, and as part of the same series of transactions or arrangement), in accordance with a plan developed by the parties at the time of the business combination; or
- the Entity or Entities of the other Group that continue to exist following the business combination do not qualify as a Group for purposes of the Convention, for example where such Entities are each sold separately to third parties (see the definition of “Group” in Article 2(v)).

1140. This means, for example, that a business combination involving the acquisition of 90 per cent of the assets and liabilities of an *existing group*, with the remaining 10 per cent being liquidated, could qualify

as an *eligible business combination*. By contrast, a business combination involving the transfer of (for example) only 20 per cent of the business of an *existing group* (the seller) to the Covered Group could not qualify as an *eligible business combination*. Conversely, a business combination involving the transfer of more than 90 per cent of the business of the seller to the Covered Group but where both the seller and the Covered Group continue to exist as separate Groups following the transfer, could not qualify as an *eligible business combination*.

1141. Following an *eligible business combination*, a Covered Group may elect to deduct the total amount that would have been the *relevant net losses* (including both *eligible net losses* and *transferred losses*) of the *transferred entity or group* at the time of the *eligible business combination*. The same rules are therefore applied to a *transferred entity or group* to calculate *transferred losses* as those that apply under paragraph 3 to calculate the *relevant net losses* of a Covered Group.

1142. The *eligible net losses* of the *transferred entity or group* are calculated under paragraph 3(a), as if the *eligible prior period(s)* of the *transferred entity or group* included only prior Period(s) that would be *eligible prior period(s)* of the Covered Group if any *unused loss* of the *transferred entity or group* were an *unused loss* of the Covered Group. This amount is therefore calculated by reference to the Financial Accounting Profit (or Loss) of each *eligible prior period(s)* of the *transferred entity or group*, after making the adjustments in paragraph 1(a) through (d), ensuring consistency in the application of the tax base rules. Importantly, at any given time, the same time limitations apply for the purpose of identifying the *eligible prior period(s)* of the *transferred entity or group* as for the Covered Group itself.

1143. The definition of Financial Accounting Profit (or Loss)” in paragraph 5(a) refers to the Consolidated Financial Statements prepared by the Ultimate Parent Entity of a Group. This means that the *eligible prior period(s)* of a *transferred group* cannot include Periods where the *transferred group* was part of any other Group. By extension, the *eligible prior period(s)* of a transferred entity can only include those Periods in which the transferred Entity was not a Group Entity of any Group.

1144. With respect to any losses transferred to the *transferred entity or group* in a separate, prior *eligible business combination* or in a prior *eligible division*, the amount of *transferred losses* is calculated under paragraph 3(b), if elected by the Covered Group. This ensures the consistent application of the tax base rules at the level of the *transferred entity or group*. Importantly, only losses incurred within the time limitations described in the definition of *eligible prior period* may be taken into consideration (subject to all other conditions of paragraphs 3(b) and 4 being met).

Box 22. Examples – Transferred losses

Example 1 – Transferred losses after an “eligible business combination”

In this example:

- The Covered Group is a large manufacturer and distributor of consumer products that has been consistently in scope under Article 3 within the applicable time limitations for loss-carry forward and that has not incurred any losses during this time. The Covered Group therefore does not have any *eligible net losses* that would comprise *relevant net losses* available for deduction pursuant to paragraph 3(a); and
- Group A is a small manufacturer and distributor of related consumer products that has never been in scope under Article 3 and that has been predominantly loss-making over recent Periods.

The Covered Group acquires Group A in the current Period as part of a transaction that qualifies as an “eligible business combination”.

If the Covered Group elects to do so, it may deduct any *transferred losses* arising from that *eligible business combination*, under paragraph 3(b), calculated in accordance with the rules in paragraph 4. To determine whether any losses can be transferred, two conditions must be met:

- First, it must be determined whether the *eligible business combination* gives rise to any amount of “transferred losses” (i.e. whether the transferred group (Group A) has an amount of unrelieved losses that would have constituted “relevant net losses” under paragraph 3, as per the rules in paragraph 4(a));
- Second, if an amount of *transferred losses* arises from the *eligible business combination*, the Covered Group must show that the business continuity requirement set out in paragraphs 3(b)(i) and 3(b)(ii) are satisfied.

In applying the business continuity requirement, the first condition (paragraph 3(b)(i)) would generally be satisfied, for example, by showing (with reference to the information reported to investors and other relevant sources) that Group A has been actively operating its business, with a view to generating revenues through similar business processes, over the previous 12 months, and with no significant divestment of the business assets driving its economic return (e.g. manufacturing facilities, retail spaces). The second condition (paragraph 3(b)(ii)) would be satisfied provided that Group A’s business is effectively continued within the Covered Group, and that any significant changes are made for relevant business purposes with a view to continuing Group A’s business activities (e.g. changes intended to implement synergies, such as to combine manufacturing processes or to share retail space). If at any time during the 24 months following the *eligible business combination*, the Covered Group implements an internal reorganisation whereby, for example –

- it divests itself of most of the assets that had been used by Group A in the ordinary course of its business;
- it lets go of the employees that had previously worked for Group A (or redeploys them to wholly unrelated activities); and
- it decides to discontinue the product lines previously manufactured and distributed by Group A and there is a corresponding reduction of third-party revenues derived from the supply of those products;

these factors, taken together, would indicate that the Covered Group has ceased to carry out the same or similar business as that of Group A prior to the *eligible business combination*. The second condition of the business continuity requirement would not be satisfied, and the deduction for *transferred losses* would not be permitted and/or would be reversed.

To deduct an amount of *transferred losses* following the *eligible business combination*, the amount that would have been the “relevant net losses” of Group A under paragraph 3(b) (referring only to periods within the applicable time limits) must be determined:

- Group A has *unused losses* in the prior Periods P-9 through P-1, which are all within the time limitations for the current Period, and are therefore all *eligible prior periods* of Group A.
- The *relevant net losses* of Group A available for transfer are equal to the cumulative Financial Accounting Losses (after adjustments) from P-9 through to P-1 (EUR 2,318 million), noting that Group A has not made any profits in prior Periods to offset such losses and has not been

involved in any prior business combinations or divisions that could give rise to *transferred losses*.

- The Covered Group must satisfy the business continuity requirement (see discussion above).
- The Covered Group can elect, under paragraph 3(b), to deduct the *transferred losses* resulting from this *eligible business combination*, i.e. the amount that would be the *relevant net losses* of Group A (EUR 2,318 million), in the computation of its adjusted profit before tax in the current Period.

Group A

(EUR'000,000 unless specified)	P-9	P-8	P-7	P-6	P-5	P-4	P-3	P-2	P-1	Transfer (Current Period)
Adjusted Revenues	6,200	6,500	6,900	7,300	7,600	7,900	8,100	8,500	9,000	-
Financial accounting profit (or loss) after adjustments	(0,093)	(0,046)	(0,069)	(0,088)	(0,213)	(0,047)	(0,356)	(0,740)	(0,666)	-
Pre-tax profit margin (%)	-1.5	-0.7	-1	-1.2	-2.8	-0.6	-4.4	-8.7	-7.4	-
<i>Relevant net losses</i> available for deduction	NA	NA	NA	NA	NA	NA	NA	NA	NA	2,318
Adjusted profit before tax										-
<i>Relevant net losses</i> available for next Period										-

Covered Group

(EUR'000,000 unless specified)	P-4	P-3	P-2	P-1	Current Period
Adjusted Revenues	86,000	88,500	89,000	91,000	98,600
Financial accounting profit (or loss) after adjustments	18,060	20,355	19,580	20,930	20,685
Pre-tax profit margin (%)	21	23	22	23	21
<i>Eligible net losses</i> available for deduction as <i>relevant net losses</i>	0	0	0	0	0
<i>Transferred losses</i> available for deduction as <i>relevant net losses</i>	0	0	0	0	2,318
<i>Relevant net losses</i> available for deduction	0	0	0	0	2,318
Adjusted profit before tax	18,060	20,355	19,580	20,930	18,367

Relevant net losses available for next Period	0	0	0	0	0
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Example 2 – ‘Successive’ Transferred Losses

The facts in Example B are the same as in Example A, except that in P-1, Group A acquired all of the assets and liabilities of Group B in a transaction reported as a business combination in Group A’s consolidated financial accounts. Group B was established in P-4 and operated in the same business line as Group A. Group B had never been in scope under Article 3, and incurred losses in P-2.

As described in Example A, Covered Group may elect, pursuant to paragraph 3.b., to deduct any *transferred losses* arising from its *eligible business combination* with Group A. The amount of *transferred losses* arising from this business combination is the amount that would have been the “relevant net losses” of Group A (referring only to prior Periods within the applicable time limit): this includes both the amount that would have been the *eligible net losses* of the Group A pursuant to subparagraph 3(a) (i.e. EUR 2,318 million, per calculations in Example A above), as well as any amount – if elected by the Covered Group – that would have been *transferred losses* of Group A pursuant to subparagraph 3(b). Therefore, as part of the Covered Group’s election to deduct *transferred losses* arising from its *eligible business combination* with Group A, the Covered Group may also elect to deduct any ‘successive’ *transferred losses* arising from Group A’s prior acquisition of Group B. As with ‘direct’ *transferred losses*, any ‘successive’ *transferred losses* may only be calculated with reference to prior Periods within the applicable time limit.

The amount of ‘successive’ *transferred losses* arising from Group A’s prior acquisition of Group B is calculated pursuant to the usual rules on *transferred losses* in paragraphs 3(b) and 4, as applied to Group A instead of the Covered Group. Therefore:

- First, it must be determined whether Group A’s acquisition of Group B would have qualified as an *eligible business combination* had Group A been a Covered Group in the relevant Period (P-1). To the extent that Group A acquired all the assets and liabilities of Group B in a transaction reported as a business combination in the Consolidated Financial Statements of Group A in P-1, such that each of the Group Entities of Group B become Group Entities of Group A, this criterion would be satisfied;
- Second, it must be determined whether that business combination would have given rise to any amount of *transferred losses* for Group A (i.e. whether the transferred group (Group B) had an amount of losses that would have constituted its “relevant net losses”). Group B only incurred Financial Accounting Losses (after adjustments) in P-2 (EUR 100 million), and did not make any subsequent profits to offset those losses prior to the acquisition by Group A in P-1. Therefore, the *relevant net losses* of Group B available for transfer are equal to the Financial Accounting Losses (after adjustments) from P-2 only (EUR 100 million). (No further election is made by the Covered Group to make any adjustments for *transferred losses* in any prior Period of Group B pursuant to paragraph 3(b))
- Third, if an amount of *transferred losses* arises from the business combination, the Covered Group must show that the business continuity requirement set out in paragraph 3(b)(ii) are satisfied. These apply separately with reference to each relevant business combination, i.e. the transfer of Group B to Group A in P-1, and the transfer of Group A to the Covered Group in the current Period (discussed in Example A). As applied to the transfer of Group B to Group A in P-1, the retrospective test in paragraph 3(b)(i) is satisfied if throughout the 12 months immediately preceding the transfer, Group B carried on the same or similar business(es) as it did immediately before the transfer. The prospective test in paragraph 3(b)(ii) is satisfied if, throughout the 24 months immediately following the transfer, Group A carries on the same or similar business(es)

available for deduction										
Adjusted profit before tax										-
<i>Relevant net losses available for next Period</i>										-
Adjusted Revenues										
Financial accounting profit (or loss) after adjustments										-
Covered Group										
(EUR'000,000 unless specified)	P-4	P-3	P-2	P-1	Current Period					
Adjusted Revenues	86,000	88,500	89,000	91,000	98,600					
Financial accounting profit (or loss) after adjustments	18,060	20,355	19,580	20,930	20,685					
Pre-tax profit margin (%)	21	23	22	23	21					
<i>Eligible net losses available for deduction as relevant net losses</i>	0	0	0	0	0					
<i>Transferred losses available for deduction as relevant net losses</i>	0	0	0	0	2,418					
<i>Relevant net losses available for deduction</i>	0	0	0	0	2,418					
Adjusted profit before tax	18,060	20,355	19,580	20,930	18,267					
<i>Relevant net losses available for next Period</i>	0	0	0	0	0					

Example C – Relevant Net Losses comprising Eligible Net Losses and Transferred Losses

The facts in Example C are the same as in Example A, except that the Covered Group incurred a significant loss in P-1. As a result, the Covered Group's *relevant net losses* available for deduction in

the current Period comprise both *eligible net losses* and *transferred losses* (arising from the *eligible business combination* with Group A).

In the current Period (P), the Covered Group's *eligible net losses* are equal to EUR 19,110 million, constituted by losses that correspond to the prior Period P-1. The Covered Group's *transferred losses* are equal to EUR 2,318 million, constituted by losses that correspond to the prior Periods P-9 through P-1 (as described in Example A above). Therefore, in the current Period, the Covered Group's *relevant net losses* are equal to EUR 21,428 million (EUR 19,110 million + EUR 2,318 million). This exceeds the amount of the Covered Group's Financial Accounting Profit (after adjustment) in the current Period, which is equal to EUR 20,685 million.

Since the Covered Group's *relevant net losses* are not fully absorbed by the Financial Accounting Profit in the current Period, the excess amount of *relevant net losses* (EUR 743 million) is potentially carried forward to the subsequent Period (P+1).

Paragraph 1(e) provides that *relevant net losses* are deducted in the chronological order of the prior Period(s) to which such *relevant net losses* correspond. Therefore, in the current Period (P), the *relevant net losses* corresponding to the prior Periods P-9 through to P-2 (EUR 1,652 million, constituted by *transferred losses*) are deducted, in chronological order, before the *relevant net losses* corresponding to P-1 (EUR 19,776 million, constituted by a combination of *eligible net losses* (EUR 19,110 million) and *transferred losses* (EUR 666 million)). In applying the chronological ordering principle, no priority is given to a certain type of loss over another, to the extent that they correspond to the same prior Period.

To determine whether any "relevant net losses" are available for deduction in P+1, the starting point is the excess amount of *relevant net losses* not deducted in the current Period (EUR 743 million). This excess amount comprises only the *unused losses* from P-1, which were incurred within the applicable time limitations. The excess amount can thus be carried forward and deducted for the calculation of the adjusted profit before tax of the Covered Group in P+1, reducing the latter from EUR 22 billion to EUR 21,257 million. The Covered Group does not have any excess amount of *relevant net losses* to carry forward to the next Period.

Covered Group

(EUR'000,000 unless specified)	P-4	P-3	P-2	P-1	Current Period (P)	P+1
Adjusted Revenues	86,000	88,500	89,000	91,000	98,600	100,000
Financial accounting profit (or loss) after adjustments	18,060	20,355	19,580	(19,110)	20,685	22,000
Pre-tax profit margin (%)	21	23	22	-21	21	22
<i>Eligible net losses</i> available for deduction as <i>relevant net losses</i>	0	0	0	0	19,110	0,743*
<i>Transferred losses</i> available for deduction as <i>relevant net losses</i>	0	0	0	0	2,318	0*

<i>Relevant net losses available for deduction in current Period</i>	0	0	0	0	21,428	0,743
Adjusted profit before tax	18,060	20,355	19,580	(19,110)	0	21,257
<i>Relevant net losses available for next Period</i>	0	0	0	0	0,743	0

* In applying the chronological ordering principle, no priority is given to a certain type of loss over another, to the extent that they correspond to the same prior Period. Therefore, in this example, the *relevant net losses* available for deduction in P+1 could be composed of any combination of the *eligible net losses* and *transferred losses* corresponding to P-1, up to a total of EUR 743 million (e.g. EUR 666 million of *transferred losses* and EUR 77 million of *eligible net losses*).

Eligible divisions

1145. Paragraph 4(b) covers an “eligible division”, which broadly comprises operations where a Group (the “predecessor group”) is divided into two or more new Groups, including the Covered Group. More precisely, an “eligible division” is defined in paragraph 5(f) to mean a transaction or arrangement in which the Ultimate Parent Entity of a single Group –

- transfers all or substantially all of its assets and liabilities to two or more Entities that each become the Ultimate Parent Entity of a new Group, including the Covered Group,
- in exchange for the pro rata issue to its shareholders of stock or securities representing the capital of these new Groups, and
- ceases to exist as a result of the transaction or arrangement.

1146. The “predecessor group” is the Group whose Ultimate Parent Entity has transferred part of its assets and liabilities to the Ultimate Parent Entity of the Covered Group in the context of an *eligible division*.

1147. The threshold of “all or substantially all” would be satisfied where at least e.g. 90 per cent of the assets and liabilities of the *predecessor group* is transferred to the Ultimate Parent Entities of new Groups resulting from the division. This threshold is determined relative to the assets and liabilities of the *predecessor group* at the time of the division. The requirement to transfer such assets and liabilities to the new Ultimate Parent Entities also covers indirect transfers, provided the transferee is a Group Entity of one of the new Groups (e.g. the transfer of assets to a wholly-owned subsidiary of one of the new Ultimate Parent Entities).

1148. It is also necessary that the *predecessor group* ceases to exist as a result of the division. For example, where any part of the *predecessor group* is not transferred to one of the new Groups, this condition will be satisfied where the non-transferred part of the *predecessor group* is liquidated as a result of the division. The definition of an *eligible division* would therefore not cover operations such as where a Group spins off part of its business to its shareholders (forming a new Group), but continues to exist as the same Group following the spin-off (in such cases the losses, if any, continue to be carried forward in that first Group, i.e., at the level of the Group in which they were generated).

1149. Following an *eligible division*, a Covered Group may elect to deduct its portion of the unrelieved losses of the *predecessor group* at the time of the *eligible division*. The deduction is available as of the first Period the Covered Group is established, i.e. the Period that immediately follows the *eligible division*. The *transferred losses* are first calculated at the level of the *predecessor group*, before being allocated between the successor new Groups following a prescribed methodology. The allocation is done on a pro-rata basis following the relative opening equity of each of the successor new Groups following the *eligible division*.

1150. *Transferred losses* in the case of an *eligible division* are the total amount that would have been the *relevant net losses* of the *predecessor group*, multiplied by the ratio calculated by dividing (1) the opening equity reported in the Consolidated Financial Statements of the Covered Group in the Period immediately following the *eligible division*; by (2) the sum of the opening equity of each of the new Groups, including the Covered Group, resulting from that *eligible division* for that same Period. However, if certain conditions, further discussed below, are met, an *alternative loss allocation factor* may be used.

1151. The amount that would have been the *relevant net losses* of the *predecessor group* comprises, pursuant to paragraph 3, *eligible net losses* and *transferred losses*. With respect to *eligible net losses* of the *predecessor group*, these are calculated under paragraph 3(a), as if the *eligible prior period(s)* of the *predecessor group* included only prior Period(s) that would be *eligible prior period(s)* of the Covered Group if any *unused loss* of the *predecessor group* was an *unused loss* of the Covered Group. This amount is therefore calculated by reference to the Financial Accounting Profit (or Loss) of each *eligible prior period(s)* of the *predecessor group*, after making the adjustments in paragraph 1(a) through (d), ensuring consistency in the application of the tax base rules. Importantly, at any given time, the same time limitations apply for the purpose of identifying the *eligible prior period(s)* of the *predecessor group* as for the Covered Group itself.

1152. With respect to any losses transferred to the *predecessor group* in a prior *eligible business combination* or in a separate prior *eligible division*, the amount of *transferred losses* is calculated under paragraph 3(b), if elected by the Covered Group. This ensures the consistent application of the tax base rules at the level of the *predecessor group*. Importantly, only losses incurred within the time limitations described in the definition of *eligible prior period* may be taken into consideration (subject to all other conditions of paragraphs 3(b) and 4 being met).

Alternative loss allocation factor

1153. Paragraph 4(b)(ii) provides the possibility for the Covered Group to use an *alternative loss allocation factor* (defined in paragraph 5(g)), to allocate losses following an *eligible division* among the new Groups resulting from that *eligible division* (or 'successor group').

1154. The default allocation proxy, described in paragraph 4(b)(i), is based on the relative opening equity of each of the new Groups. The use of this *losses allocation factor* is intended as a simple and administrable method to broadly reflect the relative size of the parts of the business of the *predecessor group* that are transferred to each of the new Groups resulting from the *eligible division*. The *losses allocation factor* is by nature not an exact measure. However, in certain circumstances, reference to the proxy of relative opening equity may yield results that are not at all correlated with the relative size of the parts of the business of the *predecessor group* transferred to each successor group. This could be the case, for example, where the economic model of the *predecessor group* involves a negligible asset base (e.g. a pure services company). It may be more appropriate, depending on the circumstances, to allocate losses to the successor groups based on an *alternative loss allocation factor* (e.g. the relative value of assets arising under transferred contracts, the relative amount of revenues earned by the transferred Group Entities, the relative value of transferred tangible and intangible assets, or the relative composition of transferred workforce (staff headcount)).

1155. If the two conditions in paragraph 4(b)(ii)(a) and (b) are met, the Covered Group may use an *alternative loss allocation factor* as defined in paragraph 5(j) (i.e. these two conditions are cumulative), to the extent that it most accurately reflects the relative size of the parts of the *predecessor group* that are transferred to each new Group, including the Covered Group, resulting from the *eligible division*.

1156. First, the Covered Group must elect to use an *alternative loss allocation factor* for purposes of paragraph 4(b).

1157. Second, all new Groups resulting from the *eligible division* must use the same *alternative allocation factor*, in a consistent manner, for purposes of paragraph 4(b)(ii). This is essential to ensure the consistent allocation of the *predecessor group's* losses.

1158. Paragraph 5(g) defines the term “alternative loss allocation factor”. It includes an exhaustive list of possible factors. If the Covered Group elects to use an *alternative loss allocation factor* in respect of an *eligible division*, it should choose the item from among subdivisions (i) through (iv) that would, given the particular characteristics of the *predecessor group*, best reflect the relative size of the parts of the *predecessor group* that are transferred to each of the new Groups resulting from that *eligible division*. The *allocation key* of the *alternative loss allocation factor* is determined by dividing the amount of a factor for the Covered Group (for example, 10,000 headcount of staff transferred to the Covered Group as a result of the *eligible division*, under subdivision (iv)) with the amount using the same factor for all new Groups resulting from the *eligible division* (for example, 50,000 staff headcount across all such new Groups, meaning the *alternative loss allocation factor* for allocating losses to the Covered Group would be 20 per cent).

Section 3 – Identification of the Designated Payment Entity

1159. Annex B Section 3 defines the Designated Payment Entity for a Covered Group for a specific Period in all cases described in Article 2(l)(ii), for purposes of the Convention. The Designated Payment Entity is the Group Entity of a Covered Group that bears the primary legal liability for taxation under the Convention.

1160. The determination of the Designated Payment Entity is determined by reference to the Parties to the Convention and the ownership structure of a Covered Group.

Paragraph 1

1161. Paragraph 1 defines the Designated Payment Entity for a Covered Group in cases identified in Article 2(l)(ii), where the Ultimate Parent Entity of a Covered Group is not a resident of a Party to the Convention at the end of a Period.

1162. In such cases, an alternative Group Entity will be the Designated Payment Entity as determined in accordance with subparagraphs (a) through (c). These rules aim to identify the entity with the highest position in the structure of the Group, and which is a resident of a Party.

1163. Subparagraph (a) provides that if the UPE of the Covered Group is not a resident of a Party, then the Group Entity that meets certain conditions for the Period is the Designated Payment Entity. Specifically, the Group Entity must be a resident of a Party, all of its Specified Equity Interests must be held directly or

indirectly by the UPE, and it must have the highest total asset value in the Covered Group among the Group Entities meeting the requirements of subparagraph (a)(i) and (ii), as included in financial statements prepared in accordance with an Acceptable Financial Accounting Standard.

1164. The Entity is identified by reference to the Entity's total asset amount in its non-Consolidated Financial Statements (or based on a measurement standard under an Acceptable Financial Accounting Standard if that entity did prepare non-Consolidated Financial Statements). As the asset base includes the value of the investment in subsidiaries, the rules should ensure the greatest capacity to meet any relevant obligations and identify the Entity most closely held (through a chain of Entities) to the Ultimate Parent Entity. The measurement of the value of such assets should be based on financial statements prepared in accordance with an Acceptable Financial Accounting Standard. However, this does not require Group Entities to prepare such statements if they are not already required to do. Such an assessment needs to only be made based on the value of the Group Entity's assets valued in accordance with an Acceptable Financial Accounting Standard.

1165. If no Designated Payment Entity is identified under subparagraph (a) for a Period, subparagraph (b) provides that the Designated Payment Entity is the Group Entity identified by applying subparagraph (a) with the word "all" in subparagraph (a)(ii) replaced by "more than 50 per cent". Finally, subparagraph (c) states that if no Designated Payment Entity is identified under subparagraphs (a) through (b), the Designated Payment Entity is the Group Entity identified by applying subparagraph (a) without regard to subparagraph (a)(ii).

1166. The intention of paragraphs 1(a)(ii), (b) and (c) is to ensure that 100 per cent owned Group Entities are tested first for the purpose of determining a Designated Payment Entity where the Ultimate Parent Entity is not resident of a Party. Where there is no 100 per cent owned Group Entity resident in a Party, Group Entities which are more than 50 per cent owned would be subject to testing. Lastly, in the absence of such Entities, all Group Entities would be subject to testing to determine which will be the Designated Payment Entity.

1167. In circumstances where two or more Groups are part of the same *dual-listed arrangement* or the same *stapled structure* the Group Entities of the Groups, Annex C Section 1(9), should be disregarded for the purposes of subparagraphs (a), (b) and (c), and paragraph 2. That is, the relevant analysis should include all the Entities within the two (or more) Groups, rather than those specifically under the single Ultimate Parent Entity.

Paragraph 2

1168. Paragraph 1(a)(iii) does not require each Group Entity to fair value its assets, but rather rely on amount reflected in the financial statements of the Group Entity. As such, the assets of a Group Entity may be based on historic cost, rather than fair market value. This may result in an operating subsidiary that is a Group Entity having a higher total asset value than its parent Entity that has 100 per cent ownership.

1169. To avoid requiring Group Entities to fair market value their assets and, at the same time, to prevent any unintended outcome, where a Group Entity (i.e. a parent Entity), that is a resident of a Party, has 100 per cent ownership interest (either directly or indirectly) in the Group Entity identified by paragraph 1(a)(iii), the parent Entity will be the Designated Payment Entity rather than the Group Entity identified by paragraph 1(a)(iii).

Paragraph 3

1170. Paragraph 3 is intended to ensure stability for a Covered Group by allowing it to maintain the same Designated Payment Entity from the immediately prior Period in a subsequent Period, unless the Covered Group elects otherwise, or certain conditions are met.

1171. These conditions are:

- the Ultimate Parent Entity is a resident of a Party in the subsequent Period. In this circumstance, the Ultimate Parent Entity will become the Designated Payment Entity.
- the Designated Payment Entity for the Period is no longer part of the Covered Group or is no longer a resident of a Party in the subsequent Period. Where this is the case, a new Designated Payment Entity must be identified in accordance with paragraph 1.
- a Group Entity of the Covered Group is identified in the subsequent Period, that falls within a higher ownership category. For example, if the Designated Payment Entity from the immediately prior Period was less than 50 per cent owned (directly or indirectly) by the Ultimate Parent Entity, and a Group Entity with more than 50 per cent ownership was identified as the Designated Payment Entity in the subsequent Period.

1172. Notwithstanding above, a Covered Group may disregard paragraph 3 for a subsequent Period, if the Covered Group would prefer the newly identified Entity in accordance with paragraph 1 to become the Designated Payment Entity.

Box 23. Examples – identifying the Designated Payment Entity (DPE)

Example 1

ABC plc, the UPE of ABC Group is located in Jurisdiction A. At the end of ABC Group's FY25 fiscal year, Jurisdiction A is not a Party to the MLC. ABC plc has four direct subsidiaries, ABC 1 limited, ABC 2 limited, ABC 3 limited, and ABC 4 limited.

ABC Group then performs an exercise to identify the DPE. It examines the other Group Entities and determines whether each Entity is located in a Party, the percentage of each Entity's Specified Equity Interests held by the UPE, and the value of assets held by each Entity. The Group prepares the following summary table for each of its Entities.

Entity name:	ABC 1 limited	ABC 2 limited	ABC 3 limited	ABC 4 limited
Jurisdiction of residence:	Jurisdiction B	Jurisdiction C	Jurisdiction D	Jurisdiction E
Party to the MLC:	Yes	No	Yes	Yes
Percentage of Specified Equity Interests held by the UPE:	55%	100%	49%	75%
Total asset value:	100	200	150	200

Based on the above table, ABC 4 Limited will be the DPE for ABC Group for FY25. ABC 2 limited cannot be the DPE as it is not resident in a Party. As there is no remaining Entity which is held 100% by the DPE, paragraph 1(b) applies, and the requirement for an Entity to be held 100% by the UPE drops to more than 50%. ABC 4 Limited has the highest asset value of the Entities which meet this threshold and is therefore the DPE for FY25.

FY26

In FY26, ABC Group increases its ownership stake in ABC 1 limited to 100%, Following the steps in paragraph 1(a), ABC 1 Limited is identified as the DPE. Paragraph 1(b) no longer applies as ABC 1 Limited is 100% held by the UPE. The option to elect for ABC 4 Limited to remain as the DPE will not apply, following paragraph 3(d), as ABC 4 Limited was identified under paragraph 1(b), and ABC 1 Limited was identified under paragraph 1(a).

FY27

In FY27, ABC Group increases its ownership stake in ABC 4 limited to 100%. Now both ABC 1 Limited and ABC 4 Limited are 100% held by the UPE. ABC 4 limited has the higher asset value (the asset values remain as per the table above in FY27). However, ABC 1 Limited has the option to elect to remain as the DPE as none of paragraphs 3(a), (b), (c) or (d) apply. The election is effective provided ABC 4 limited agrees.

Example 2

Red plc, the UPE of Red Group is located in Jurisdiction A. At the end of Red Group's FY25 fiscal year, Jurisdiction A is not a Party to the MLC.

Red Group then performs an exercise to identify the DPE. It examines the other Entities of the Group and determines whether each Entity is located in a Party, the percentage of each Entity's Specified Equity Interests held by the UPE, and the value of assets held by each Entity. The Group prepares the below summary table for each of its Entities.

Red plc directly holds 100% of the Specified Equity Interests of Blue Limited and Green Limited. Blue Limited directly holds 100% of the Specified Equity Interests of Yellow Limited and Orange Limited. The value of each subsidiary in the non-Consolidated Financial Statements of Blue Limited and Green Limited are carried at historic cost rather than market value. The total asset value in the non-Consolidated Financial Statements of each entity is as follows:

Entity name:	Blue limited	Green limited	Yellow Limited	Orange limited
Jurisdiction of residence:	Jurisdiction B	Jurisdiction C	Jurisdiction D	Jurisdiction E
Party to the MLC:	Yes	Yes	Yes	Yes
Percentage of Specified Equity Interests held by the UPE:	100%	100%	100%	100%
Total asset value:	100	150	200	50

Following the steps outlined in paragraph 1(a), Yellow Limited would be identified as the Group Entity with the highest asset value, as it is resident in a Party. However, following paragraph 2, Blue Limited will be identified as the DPE. This is because it holds 100% of the Specified Equity Interests of Yellow Limited and is resident in a Party.

Example 3

This example follows Example 2 but, in this case, both Blue Limited and Green Limited hold 50% of the Specified Equity Interests of Yellow Limited. In this situation Yellow Limited is identified as the DPE, as neither Blue Limited or Green Limited hold all the Specified Equity Interests of Yellow Limited. That is, paragraph 2 does not apply and therefore Yellow Limited is the DPE, as identified under paragraph 1(a).

Section 4 – Elimination Profit (or Loss)

1173. Annex B Section 4 defines the “elimination profit (or loss)” of a Covered Group for a Period in a Jurisdiction, which is used as the basis for a number of operative provisions of the Convention. The Elimination Profit (or Loss) in a Jurisdiction is used to calculate the amount of profit used for purposes of the elimination of double taxation.

Paragraph 1

Elimination Profit (or Loss)

1174. Paragraph 1 contains the core definition of the term “elimination profit (or loss)” of a Covered Group for a Period in a Jurisdiction. This term is defined to be equal to the sum of the *entity elimination profit (or loss)* of each Group Entity located in that Jurisdiction and the sum of the *taxable presence elimination profit (or loss)* of each Taxable Presence in that Jurisdiction for the Period, reduced by *relevant elimination net losses* in that Jurisdiction.

1175. *Entity elimination profit (or loss)* is defined in paragraph 2, *taxable presence elimination profit (or loss)* is defined in paragraph 3, and *relevant elimination net losses* are defined in paragraph 6. Paragraph 4 contains specific rules to disregard some or all of the profits of a *flow-through entity* in some circumstances and instead recognise such profits in another Group Entity or Taxable Presence and paragraph 5 contains rules defining the location of a Group Entity or Taxable Presence.

1176. The overall design of the Elimination Profit (or Loss) adopts the Entity Financial Accounting Profit (or Loss) of each Group Entity within a Covered Group as its starting point, thereby ensuring a consistent approach to the determination of profitability in each Jurisdiction. Certain adjustments are made to reconcile differences in this entity-based measure of *accounting profit* with commonly observed characteristics of the domestic tax bases of Inclusive Framework members.

1177. Paragraph 2 provides that *entity elimination profit (or loss)* is determined based on *accounting profit* per Consolidated Financial Statements subject to several book-to-tax adjustments that reconcile *accounting profits* determined under Acceptable Financial Accounting Standards with commonly observed adjustments made for tax purposes. Paragraph 3 clarifies the determination of *taxable presence*

elimination profit (or loss) which is included in the Elimination Profit (or Loss) of a Covered Group in a Jurisdiction to recognise taxation of a non-resident person on a net income basis. Paragraph 3 requires the inclusion of such net income in the Elimination Profit (or Loss) of the Jurisdiction imposing such taxation. Finally, paragraph 6 determines the *relevant net losses* that are used to reduce the *elimination profit (or loss)* of a Covered Group in a Jurisdiction for a Period.

Paragraph 2

Entity Elimination Profit (or Loss)

1178. Paragraph 2 contains the definition of the term “entity elimination profit (or loss)” for a Period. This measure of profitability is equal to the “Entity Financial Accounting Profit (or Loss)” of a Group Entity for that Period after making a number of adjustments and subject to the exclusion of specified entities.

1179. *Entity elimination profit (or loss)* specifically excludes profits or losses of *regulated financial institutions* and *extractives entities*. The rules governing determination of the Elimination Profit (or Loss) of a *qualifying extractives group* are found in Annex B Section 3. For instance, Annex B Section 3(1)(f) provides that *entity elimination profit (or loss)* shall be replaced with either the term “mixed entity elimination profit (or loss)” in relation to mixed entities or “non-extractives entity elimination profit (or loss)” in relation to *non-extractives entities*. The calculation of the Elimination Profit (or Loss) for a *disclosed segment* is determined following the approach in Annex B Section 4. Annex B Section 4(7)(a) provides how to calculate *entity elimination profit (or loss)* of the *mixed segment entity* and the Elimination Profit (or Loss) of the *covered segment*.

1180. The term “Entity Financial Accounting Profit (or Loss)” is positively defined in Article 2(p) to mean the profit or loss determined for an Entity (before any consolidation adjustments eliminating intra-group transactions) in preparing Consolidated Financial Statements of the Covered Group. This measure of profit (or loss) takes into account all of the entity’s revenue and expenses (excluding items included in the computation of “other comprehensive income”), including income tax. Following this approach the relevant period for determining *entity elimination profit (or loss)* (and *taxable presence elimination profit (or loss)*) will always align with the relevant period for determining *elimination profit (or loss)* of a Group and therefore the Period of the Covered Group for purposes of the Convention. As explained in paragraph 1176 of the Explanatory Statement, such an approach ensures consistency in determining jurisdictional profitability.

1181. The Consolidated Financial Statements of the Covered Group are prepared by consolidating the financial statements of Group Entities. The financial statements of a Group Entity used for this purpose are prepared following the same Acceptable Financial Accounting Standard as that used in the preparation of the Consolidated Financial Statements of the Covered Group and it is these financial statements that are used for the purpose of determining Entity Financial Accounting Profit (or Loss). The term Acceptable Financial Accounting Standard is defined in Article 2(a).

Excluded Items of Income or Expense

1182. Using the Entity Financial Accounting Profit (or Loss) as the starting point, paragraph 2(a) contains an exhaustive list of items of income and expense that must then be disregarded to arrive at the *entity elimination profit (or loss)* of each Group Entity. Each adjustment is described below.

Adjustments Relating to Income Tax Expense

1183. Paragraph 2(a)(i) provides for the reversal of income tax expense (or income) that was included in calculating the Entity Financial Accounting Profit (or Loss) of a Group Entity under an Acceptable Financial Accounting Standard, similar to the adjustment made to Adjusted Profit Before Tax of the

Covered Group under Annex B Section 2(a)(i). As explained in paragraph 1083 of the Explanatory Statement, this item is excluded on the basis that income tax expenses are usually not deductible for corporate income tax purposes in Inclusive Framework jurisdictions. It covers both current and deferred income tax expense (or income). Current income tax expense (or income) is the amount of income tax that a Group would be expected to pay (or recover) in respect of the Period, whilst amounts of income tax payable (or recoverable) in respect of future Periods are recognised as deferred tax liabilities (or assets).

1184. The characterisation of a particular tax or levy as income tax for purposes of this provision depends on its treatment under the applicable Acceptable Financial Accounting Standard. Generally, financial accounting standards define income taxes broadly, including all domestic and foreign taxes based on *taxable profits*, and taxes on distributed profits such as withholding taxes. Accordingly, the deduction of these taxes in the calculation of the Entity Financial Accounting Profit (or Loss) will be reversed in the calculation of the *entity elimination profit (or loss)* to the extent that they are considered current or deferred income tax expense (or income) under the applicable Acceptable Financial Accounting Standard. In contrast, the deduction of taxes not considered current or deferred income tax expense (or income) under the applicable Acceptable Financial Accounting Standard in the calculation of the Entity Financial Accounting Profit (or Loss) will not be adjusted in the calculation of the *entity elimination profit (or loss)* under this provision. For example, customs and excise duties are not considered to be current and deferred income tax expense (or income) under applicable Acceptable Financial Accounting Standards.

1185. In addition, paragraph 2(a)(i) does not include interest charges for late payment of tax, as explained in paragraph 1084 of the Explanatory Statement. In general, Covered Groups may be subject to interest charges for late payments of an amount of income tax due, but depending on the particular financial accounting standard, those interest charges can be recognised as either a tax expense or a financial charge. Therefore, allowing a deduction for this type of interest charge in computing the *entity elimination profit (or loss)* ensures consistency in the treatment of interest charges.

1186. Also, for reasons of neutrality, deductions for tax penalties will be reversed in many cases, regardless of their treatment under an Acceptable Financial Accounting Standard. Where tax penalties are recognised as a tax expense under an Acceptable Financial Accounting Standard, the deduction of tax penalties will be reversed in calculating *entity elimination profit (or loss)* under paragraph 2(a)(i). In other cases, where a tax penalty is not recognised as a tax expense under an Acceptable Financial Accounting Standard, the deduction of the penalty would be reversed in calculating *entity elimination profit (or loss)* under paragraph 2(a)(v) provided it meets the threshold in that provision.

Adjustments Relating to Specified Equity Interests

1187. Paragraph 2(a)(ii) provides for the reversal of dividends or other distributions received or accrued in respect of Specified Equity Interests (as defined in Article 2(jj)) that were reflected in the Entity Financial Accounting Profit (or Loss) of a Group Entity under an Acceptable Financial Accounting Standard. This provision covers dividends or other distributions of profits regardless of their form.

1188. Paragraph 2(a)(iii) provides for the reversal of gain, profit or loss arising from a series of items attributable to a Specified Equity Interest. Those are (i) disposition of a Specified Equity Interests; (ii) changes in the fair value of a Specified Equity Interest; and (iii) profit or loss in respect of a Specified Equity Interest in an Entity included under the equity method of accounting in the Consolidated Financial Statements of the Covered Group under an Acceptable Financial Accounting Standard, other than profit or loss derived from an unincorporated Joint Venture in which the Covered Group has joint control unless that Joint Venture is the Ultimate Parent Entity of another Covered Group.

1189. Paragraph 2(a)(iii)(B) relates to changes in the fair value of a Specified Equity Interest that is accounted for using a fair value accounting method, including mark-to-market. A fair value method re-values the equity ownership interest periodically, with changes in value reported as gain or loss, either in the profit and loss statement or other comprehensive income. Fair value method gains or losses in respect of Specified Equity Interest are excluded from the *entity elimination profit (or loss)* computation.

1190. Excluded fair value gains require a negative adjustment (and excluded fair value losses require a positive adjustment) if they are to apply for purposes of paragraph 2(a)(iii)(B). To the extent such fair value gains and losses are recorded in other comprehensive income instead of the profit and loss statement, they may already have been excluded from the *entity elimination profit (or loss)* and no adjustment is necessary under paragraph 2(a)(iii)(B). It is noted that this specific provision with respect to Specified Equity Interest accounted for under fair value accounting included in paragraph 2(a)(iii)(B) shall take precedence over paragraph 2(b)(vi) where both would otherwise apply.

1191. Paragraph 2(a)(iii)(C) relates to profit or loss arising from a Specified Equity Interest accounted for using the equity method of accounting in the Consolidated Financial Statements of the Covered Group, except profit or loss derived from an unincorporated Joint Venture in which that Covered Group has joint control unless that Joint Venture is the Ultimate Parent Entity of another Covered Group. The definition of Joint Venture in Article 2(z) includes Entities that are subject to joint control by a Group Entity and accounted for under the equity method by the Covered Group and in this way a Joint Venture could include an incorporated Entity, a partnership or other forms of Joint Venture. The adjustment required in respect of Specified Equity Interests accounted for under the equity method may be a positive or negative amount depending upon whether the Covered Group reported net income or net loss. An equity method net income will require a negative adjustment to the Entity Financial Accounting Profit (or Loss). An equity method loss will require a positive adjustment to the Entity Financial Accounting Profit (or Loss). Acceptable Financial Accounting Standards typically require equity method accounting when the Covered Group holds a significant but non-controlling interest in an entity, ordinarily between 20 per cent and 50 per cent of the equity ownership interests in an entity.

1192. Profit or loss derived from an unincorporated Joint Venture is an exception to this reversal. This is on the basis that Joint Ventures are not consolidated in the accounts of any other group because they are jointly controlled, and thus it is necessary to include the profits of an unincorporated Joint Venture proportionately in the Elimination Profit (or Loss) of its owners to avoid such income being ignored for purposes of the Convention. Accordingly, profit or loss recognised in the Entity Financial Accounting Profit (or Loss) of a Group Entity that derives from an interest in an unincorporated Joint Venture will not be subject to an adjustment under clause (C). For example, assume Entity A is a Group Entity of a Covered Group that has a 25 per cent equity ownership interest in an unincorporated Joint Venture. Assume further that the unincorporated Joint Venture recognises a profit of 100 in its profit or loss statement in Year 1. Entity A reports a Financial Accounting Profit of 500 in the same period, which accordingly includes a profit of 25 recognised under the equity method from its investment in the unincorporated Joint Venture. Other things being equal, the Entity Financial Accounting Profit (or Loss) of Entity A would be 500 as the profit from its investment in the Joint Venture is not subject to a reversal under clause (C). Incorporated Joint Ventures are not subject to this provision and are considered separately at paragraph 1476.

1193. For purposes of this exception, an unincorporated Joint Venture does not require the Group Entity to have a minimum percentage of ownership. However, it requires all the parties, or a group of the parties, to the arrangement, including the relevant Group Entity, to have joint control and rights to the net assets of the unincorporated Joint Venture. Though joint control generally requires the unanimous consent of all the parties with respect to decisions about the activities of the Joint Venture, the reference to joint control must be specifically considered in the context of the Acceptable Financial Accounting Standard used by

the Covered Group to produce its Consolidated Financial Statements. It also requires that the profit or loss of the unincorporated Joint Venture be recognised under the equity method of accounting.

1194. In the case that an unincorporated Joint Venture that is the Ultimate Parent Entity of a Covered Group, the unincorporated Joint Venture itself will be a Group Entity and all profits of that Joint Venture will be included in the determination of its *entity elimination profit (or loss)*. To avoid such profits being counted twice for purposes of the Convention, they are excluded from the *entity elimination profit (or loss)* of the investors in the unincorporated Joint Venture.

Adjustments Relating to Policy Disallowed Expenses

1195. Paragraph 2(a)(iv) provides for the reversal of expenses incurred with respect to illegal payments, which are generally treated as expenses for purposes of financial accounting rules, but which are disallowed as expenses under this Article for reasons of policy, as indicated in paragraph 1093 of the Explanatory Statement.

1196. The concept of “illegal payments” is intentionally broad in order to cover a wide range of disallowed expenses, including bribes and kickbacks. Legal treatment of certain payments can vary across Jurisdictions, so, to ensure consistency, a payment is considered “illegal” for purposes of the Convention if it is illegal under the laws applicable to the Ultimate Parent Entity, the Group Entity that made the payment or the Group Entity that incurred the expense.

1197. The provision is intended to cover the case where the Ultimate Parent Entity itself does not pay bribes. For example, if the laws applicable to the Ultimate Parent Entity determine that the instruction by the Ultimate Parent Entity for another Group Entity to pay bribes is illegal, the expenses for such payments would fall within paragraph 2(a)(iv) even if such payment is not illegal under the laws applicable to the Group Entity that made such payments. This rule would also cover any scenario where the payment is illegal only in the Jurisdiction of the payer Group Entity, and not the Entity that incurred the expense or the Ultimate Parent Entity (assuming those are all different), as might occur in limited instances where one Group Entity makes payment on behalf of another.

1198. Paragraph 2(a)(v) provides for the reversal of expenses for fines or penalties that equal or exceed EUR 50 000 per occurrence (or in the case of a fine or penalty imposed on a periodic basis until corrective action is taken, in the aggregate within a single Period) for a Group Entity or the equivalent in the functional currency of the Group Entity. For the avoidance of doubt, such fines or penalties would include extra territorial fines imposed by organisations located in a Jurisdiction other than the Jurisdiction where the liable Group Entity is located (e.g., fines or penalties related to competition law). The deduction of fines and penalties imposed by a government is commonly disallowed for tax purposes. The policy rationale for denying a deduction for fines and penalties is to confine their economic cost to the person that committed the act subject to the fine or penalty. This rationale would be diluted if the taxpayer were allowed to share the burden of the penalty with all taxpayers (by way of a tax deduction for it). However, fines and penalties, particularly those for minor offenses such as traffic tickets, are more frequent than bribes and vary widely in amount. For example, they can range from a EUR 50 traffic ticket incurred by a transportation company to a multi-million EUR fine for securities law violations incurred by a large corporation.

1199. Recognising the de minimis nature of many fines and penalties, the *entity elimination profit (or loss)* only includes adjustment for fines and penalties that each equal or exceed EUR 50 000 (or the equivalent in an Entity’s functional currency). However, the disallowance applies also to fines that may be levied in respect of the same activity on a periodic basis (e.g., daily fines) that in the aggregate equal or exceed EUR 50 000 (or the equivalent) in a single period for a specific entity. For a Group Entity that does not use EUR as its functional currency, the threshold is applied by reference to the equivalent amount in

the functional currency of the Group Entity. A periodic fine or penalty includes a fine or penalty that is assessed periodically until corrective action is taken but does not include separate fines that are for the same type of offense committed upon multiple occasions, such as traffic tickets. The purpose of the threshold is to continue to allow deductions for smaller fines that may not be specifically recorded as separate items in the accounts of the Group Entity. This approach avoids the complexity of tracking small fines and penalties for purposes of the Convention while at the same time preventing Groups from escaping liability because of a few large fines or penalties.

1200. Interest charges for late payment with respect to tax or other liabilities to a government (including liabilities to government agencies and instrumentalities) are not considered fines or penalties for purposes of this provision, and do not need to be added back to *entity elimination profit (or loss)*.

Adjustments Relating to Amount A Compensation Payments

1201. Income from, or expenses incurred with respect to, compensation payments described in Article 13(9) are excluded from the determination of *entity elimination profit (or loss)* to the extent that the compensation payment does not exceed the *Amount A compensation payment limit*. Further discussion of this exclusion can be found in the context of Article 13(9).

Adjustments for related investment revenue

1202. Paragraph 2(a)(vii) provides that the inclusion of any *related investment revenue* in *entity elimination profit (or loss)* should be reversed in calculating *entity elimination profit (or loss)* and similarly, the deduction of any expenses directly associated with *related investment revenue* should be reversed. The definition of *related investment revenue* is included in Annex C Section 2(3)(q) and is explained from paragraph 1805.

1203. *Related investment revenue* is excluded from the calculation of the Adjusted Revenues of a Group that includes a *regulated financial institution* and therefore must be removed from the Elimination Profit (or Loss). The total expenses that are directly associated with *related investment revenue* are similarly not included when calculating the Adjusted Profit Before Tax of a Group that includes a *regulated financial institution* and therefore should not be reflected when determining the Elimination Profit (or Loss). As *related investment revenue* may be earned both by *regulated financial institutions* and by Group Entities that are not *regulated financial institutions*, it must be separately excluded from the Elimination Profit (or Loss) of Group Entities that are not *regulated financial institutions* in cases where the Covered Group includes a *regulated financial institution*. Similarly, given the directly associated expenses can also be incurred by Group Entities that are not *regulated financial institutions*, they must be separately removed from the Elimination Profit (or Loss) of those Entities.

Adjusted Items of Income or Expense

1204. Paragraph 2(b) contains an exhaustive list of provisions that require recalculation of income and expense items that are taken into account in the calculation of the *entity elimination profit (or loss)* of each Group Entity. Each adjustment is described below.

Acquired equity basis adjustment

1205. Paragraph 2(b)(i) applies where the Covered Group acquired on or after the date of entry into effect described in Article 49 an equity interest in an Entity for total consideration in excess of EUR 5 million such that the acquired Entity became a Group Entity of the same Covered Group. In such circumstances, the Covered Group must use the accounting carrying value of the assets and liabilities that was applicable from the perspective of the acquired Entity immediately before the acquisition for the purpose of calculating

(a) any depreciation, amortisation or other impairment amount with respect to those assets or liabilities, and (b) calculating any gain or loss in the event of the disposition of those assets or liabilities by the Group Entity after deducting any depreciation, amortisation or other impairment amount determined under subparagraph (a). In other words, the acquired Group Entity maintains the carrying value of its own underlying assets and liabilities as at the date of acquisition. In determining whether the consideration paid to acquire the relevant equity interest, the EUR 5 million threshold refers to the consideration provided in respect of the cumulative total consideration paid in respect of the Covered Group's equity interest in the Entity where this has been acquired over multiple transactions.

1206. For example, if the Covered Group acquired an initial non-controlling interest for consideration of EUR 3 million in Period 1 and subsequently acquired a further interest for EUR 3 million in Period 2 that led to the Covered Group gaining a controlling interest in the investee, the total consideration taken into account in determining that the EUR 5 million threshold has been met would be the sum of the two payments (i.e., EUR 6 million). Where a Covered Group acquires an initial non-controlling interest, disposes of part of that interest and then obtains a further interest resulting in the Covered Group gaining control of the investee, the relevant total consideration would be equal to the sum of the two payments to acquire equity interests less the consideration received for disposition of the equity interests.

1207. If the acquired Group Entity subsequently disposes of the assets and liabilities, any gain or loss on disposition of such assets would also be determined based on the carrying value of the assets and liabilities that was applicable from the perspective of the acquired Entity as at the date of acquisition, after deducting any depreciation, amortisation or other impairment amount determined as described above. Given that gains and losses on dispositions of equity interests are excluded from the Elimination Profit (or Loss) of the disposing entity, whereas the gains and losses on dispositions of assets are included, it is important to ensure that any step up in basis is not recognised by the acquirer with respect to the acquired Group Entity in the case of an equity acquisition. With respect to this adjustment, and the subsequent adjustment included in paragraph 2(b)(ii), a materiality threshold is adopted to ensure that an unnecessary administrative burden is not imposed on Covered Groups to perform these adjustments where the impact would be relatively minor. Where the materiality threshold is not satisfied, no adjustment would be performed to the *entity elimination profit (or loss)* of the acquired Group Entity with respect to the income or expense that would otherwise be subject to this adjustment.

1208. The applicable materiality threshold with respect to this adjustment under Annex B Section 4(2)(b)(i) is set lower than the corresponding materiality threshold in the Adjusted Profit Before Tax under Annex B Section 2(1)(b)(iii) to recognise that smaller transactions may have a proportionately greater impact at a jurisdictional level as compared to group level.

Gain or loss on asset spreading

1209. Paragraph 2(b)(ii) provides for the spreading over five periods of a gain or loss from dispositions that occur on or after the date of entry into effect described in Article 49 of assets other than inventory where the gain or loss exceeds EUR 5 million. Accordingly, paragraph 2(b)(ii) allocates such a gain or loss evenly among the Period in which the disposition occurs and each of the four subsequent periods. The rationale for this adjustment is to ensure the smoothing of gains or losses that do not result in a corresponding change to depreciation and payroll in the Period and would otherwise result in an abnormally high or low Return on Depreciation and Payroll in the period in which the disposition occurs.

1210. This provision also clarifies the hierarchy of treatments with respect to interaction of this adjustment with other adjustments. This adjustment shall not apply to the extent that gains or losses on asset dispositions are otherwise excluded from the Elimination Profit (or Loss) by virtue of paragraph 2(e) and (f). Where such gains are only partially excluded for the Elimination Profit (or Loss) by virtue of paragraph

2(e) and (f) (e.g., where only part of the value of the asset disposition is subject to tax deferral under a *qualifying reorganisation*) then the remaining part will be subject to spreading.

1211. No interaction is intended between this provision and a profit allocation adjustment under paragraph 2(c). Where an asset is sold between related parties, any gain or loss based on accounting recognition of the disposing Entity would be spread according to paragraph (b)(ii). If the *taxable presence profit amount, profit allocation amount, or excluded profit amount* with respect to this disposition does not match the accounting gain, any change in the *taxable presence profit amount, profit allocation amount, or excluded profit amount* would be subject to spreading under paragraph 2(c).

1212. This provision applies on an asset-by-asset basis such that the applicable materiality threshold is considered for each asset in isolation, and the spreading is then applied in isolation to each asset that satisfies this threshold.

Stock-based compensation expenses

1213. Paragraph 2(b)(iii) requires a Group Entity to add back the amount of stock-based compensation recognised as an expense in the calculation of its Entity Financial Accounting Profit (or Loss). Instead, the amount recognised for purposes of calculating *entity elimination profit (or loss)* is the amount claimed as a deduction in the computation of the Group Entity's taxable income for corporate income tax purposes.

1214. For financial accounting purposes, companies generally account for stock-based compensation based on the present value of the stock option at the time of issuance and amortise that amount over the exercise period. The company may adjust its estimate of the amount of the stock-based compensation expense and thus the amount taken as an accounting expense based on changes in circumstances during the exercise period. If the market value of the stock increases over the exercise period and this increase is not recognised as an expense for financial accounting purposes, the corporation will deduct an amount for tax purposes that is higher than the amount expensed for financial accounting purposes, which is a permanent difference.

1215. Under paragraph 2(b)(iv), in instances where an option issued as stock-based compensation expires without exercise, the Group must treat the amount previously included as an expense in the computation of the *entity elimination profit (or loss)* as additional income. This rule prevents the Group Entity from obtaining a deduction for an item that will never be paid.

1216. With respect to both paragraph 2(b)(iii) and (iv), the entire amount of the stock-based compensation expense is subject to the condition that the item of expense must be susceptible to being reliably and consistently traced to the Group Entity that received the property, use of property, services, etc. for which the stock-based compensation was provided. The adjustments only apply to the Group Entity that incurred the expense and received the property (including use of property) or services for which the stock-based compensation was provided. The stock provided does not need to be stock issued by the Group Entity that incurred the relevant expense. However, the expense for stock-based compensation is not allowed to the Group Entity that issued the shares used as compensation, unless it received the property, services, etc. for which the compensation was paid. For example, if a Group Entity provides stock-based compensation to its executives in the form of stock in the Ultimate Parent Entity, the Group Entity, not the Ultimate Parent Entity, deducts the value of the stock. Only one Group Entity is allowed to deduct stock-based compensation and only if that Group Entity is allowed a deduction for such stock-based compensation for local tax purposes. Thus, if the accounting expense needs to be moved from the Group Entity whose shares are used as the compensation to the Group Entity that incurred the expense, the expense of the Group Entity that issued the shares and the reimbursements from the Group Entity that

incurred the expense should be in equal amounts based on the amount of the stock-based compensation expense allowed in the Consolidated Financial Statements.

Pension liability expenses

1217. Pension liability expenses that are related to a pension plan provided through a *pension fund* are allowed as expenses in the computation of *entity elimination profit (or loss)* to the extent of net contributions to a *pension fund* during the Period. The adjustment for pension liability expenses required by paragraph 2(b)(v) provides for replacement of pension liability expenses and pension earnings that are related to a pension plan provided through a *pension fund* and that are included in computing the Group Entity's Entity Financial Accounting Profit (or Loss) with the amount of net contributions to a *pension fund* for the Period. The adjustment to Entity Financial Accounting Profit (or Loss) will be a positive amount (increasing income) if the amount accrued as an expense in the financial accounts exceeds the contributions for the year. It will be a negative amount (decreasing income) in Periods in which the contributions exceed the expense accrued in the financial accounts. In the company pension schemes of some Jurisdictions, the annual accrued pension expense is always equal to the annual net contribution amount. In such cases, there would be no adjustment under paragraph 2(b)(v).

1218. Paragraph 2(b)(v) only applies to the pension liability expenses and pension earnings of pension plans that are provided through a *pension fund*. Thus, pension expenses that are accrued for direct pension payments to former employees are not subject to this adjustment and should be taken into account at the same time and in the same amount as they are accrued as an expense in the computation of the Entity Financial Accounting Profit (or Loss).

Fair value or impairment adjustments

1219. Paragraph 2(b)(vi) provides for the reversal of gains or losses with respect to an asset or liability that is attributable to fair value or impairment accounting in the calculation of Entity Financial Accounting Profit (or Loss). Instead, gains and losses are recognised upon eventual disposal using the realisation principle. Paragraph 2(b)(vi) applies with respect to all assets and liabilities of all Group Entities. However, it does not apply to a *portfolio shareholding* of a Group Entity for which fair value accounting is used, as paragraph 2(a)(iii)(B) already expressly requires the reversal of a gain, profit or loss arising from changes in the fair value of such an interest.

1220. Under paragraph 2(b)(vi), a gain or loss will arise when the asset or liability is disposed of or liquidated, rather than as its value changes due to changes in market value or impairments. Accordingly, to determine *entity elimination profit (or loss)*, under paragraph 2(b)(vi)(A), a Group Entity must exclude a fair value or impairment gain or loss in respect of assets or liabilities from the computation of *entity elimination profit (or loss)* and, under paragraph 2(b)(vi)(B), record gains or losses on such assets or liabilities only when realised upon a disposition or liquidation. For this purpose, the carrying value of the asset or liability is its carrying value at the date the asset was acquired (or the liability was incurred) less the sum of any depreciation or amortisation that was determined for the asset or liability and included in Entity Financial Accounting Profit (or Loss) of the Group Entity since acquisition.

1221. For example, if a Group Entity holds convertible debt in a start-up company and the company performs poorly in its first few years, the Group Entity may be required, under the Acceptable Financial Accounting Standard, to recognise a fair value loss on the investment. If the start-up is eventually acquired by an unrelated purchaser and the Group Entity disposes of the convertible debt for its original acquisition cost, the "gain" reported in the Entity Financial Accounting Profit (or Loss) upon the disposition of the convertible debt is not a true economic gain and therefore should not be subject to re-allocation under the Convention. Paragraph 2(b)(vi) produces this outcome by requiring the Group Entity to determine the gain

upon disposition based on the original cost of the asset and to reverse any fair value loss. In instances where a disposed asset was previously subject to depreciation or amortisation charges prior to its classification as an asset accounted on a fair value basis, any such depreciation or amortisation will be deducted from the carrying value to avoid being double counted.

Adjustments Relating to Profit Allocation

1222. Paragraph 2(c) provides that Group Entities will make *profit allocation adjustments* in determining *entity elimination profit (or loss)*. The definition of *profit allocation adjustments* is included in Paragraph 7. This definition is discussed in paragraph 1337 of this Explanatory Statement below.

1223. This adjustment shall not apply to the extent that the transaction that is otherwise subject to an adjustment under this provision is excluded from the Elimination Profit (or Loss) by virtue of paragraph 2(e) and (f). Where such gains are only partially excluded for the Elimination Profit (or Loss) by virtue of paragraph 2(e) and (f) (e.g., where only part of the value of the asset disposition is subject to tax deferral under a *qualifying reorganisation*) then the remaining part will be subject to this adjustment.

Adjustments Relating to Prior Period Adjustments

1224. Annex B Section 2(2) defines the term “prior period adjustment”. The *prior period adjustment* with respect to a Covered Group, as reflected in the Adjusted Profit Before Tax and adapted for this Elimination Profit (or Loss), means an adjustment corresponding to all changes in the opening equity of the Period that relate to a correction of an error in the determination of the Financial Accounting Profit (or Loss) or a change in an accounting principle or policy and are attributable to transactions or other events that would have impacted the determination of Adjusted Profit Before Tax for (i) a prior Period when the Covered Group was a Covered Group or (ii) a Period that would be an *eligible prior period* had there been an *unused loss* with respect to that prior Period, had they initially been recorded in the prior Period on the same basis as that reflected in the relevant changes in the opening equity of the Period. Further, Annex B Section 2(2)(c) contains rules requiring the prospective spreading of the *prior period adjustment* where a materiality threshold is met.

1225. The definition of *prior period adjustment* in Annex B Section 2(2) applies in the context of the Adjusted Profit Before Tax of a Covered Group and is adapted for the purpose of determining the *entity elimination profit (or loss)* of a Group Entity, via the operation of paragraph 2(d).

1226. Included in paragraph 2(d)(i) and (ii) are the following provisions that adapt the *prior period adjustment* definition in context of *entity elimination profit (or loss)*:

- The term Financial Accounting Profit (or Loss) in Annex B Section 2(2) shall be replaced by the term Entity Financial Accounting Profit (or Loss);
- The term Adjusted Profit Before Tax in Annex B Section 2(2) shall be replaced by the term Elimination Profit (or Loss)."

1227. Further, paragraph 2(d)(iii) provides for the adaption of spreading provisions such that where the *prior period adjustment* for the Group Entity in the Period exceeds EUR 5 million, the adjustment is spread pro rata over the current Period plus the greater of the two subsequent Periods, or the number of subsequent Periods equal to the number of Periods to which the *prior period adjustment* in the Period relates minus one. If the *prior period adjustment* for the Group Entity in the Period is less than EUR 5 million the total amount is included in the Group Entity's *entity elimination profit (or loss)* in the Period in which the triggering event occurs.

1228. The adjustments to *entity elimination profit (or loss)* made in accordance with subparagraph (d) will generally align with corresponding adjustments at a Group level to determine Adjusted Profit Before Tax. This is because Consolidated Financial Statements are equivalent to the aggregation of entity financial statements used in consolidation, subject to elimination adjustments required to net off certain intra-group transactions. Therefore, any *prior period adjustments* included at a Covered Group level will be reflected in a corresponding *prior period adjustment* at a Group Entity level.

1229. In general, when a Group Entity corrects an error in the determination of Entity Financial Accounting Profit (or Loss) in a previous Period, it may need to re-determine its opening equity (i.e., the equity at the beginning of the Period) in the Period in which the error was discovered or as soon as practicable. The adjustments may increase or decrease the opening equity depending upon the nature of the error. For example, an erroneous exclusion of revenue in a previous Period will generally result in an increase to opening equity and a corresponding increase to income in the computation of *entity elimination profit (or loss)* in the Period when the error is corrected.

1230. Similarly, when a Group Entity changes an accounting principle or policy used in the determination of its *entity elimination profit (or loss)*, it may be required to re-determine its opening equity as if it had used the new accounting principle or policy in previous Periods. The change in accounting principle or policy may require either an increase or decrease in the opening equity. This is because an increase or decrease in opening equity represents the net amount that under the new accounting principle or policy would have been included in that computation in a previous Period. The effect of the adjustment under subparagraph (d) should correspond to the adjustment to opening equity. Thus, if a change in accounting principle or policy decreases opening equity, the *prior period adjustment* would be a negative adjustment that has the same effect as an additional deduction in the computation of *entity elimination profit (or loss)*. Conversely, if a change in accounting principle or policy increases opening equity, the *prior period adjustment* would be a positive adjustment that has the same effect as an additional item of income in the computation of *entity elimination profit (or loss)*.

1231. To the extent that an error or a change in an accounting principle or policy is attributable to a Period that is prior to the application of the Convention to the Covered Group (and that is not a Period that would be an *eligible prior period* and would also not be an *eligible prior period* if the requirement that an *unused loss* must be observed with respect to that prior Period were removed), the adjustment to opening equity does not result in a “prior period adjustment” under subparagraph (d). By defining the relevant prior Periods for which *prior period adjustments* will be considered in this way, the Period taken into account for *prior period adjustments* is aligned with that same Period during which losses might be carried forward. It is intended that this adjustment will apply equally with respect to both upward and downward *prior period adjustments*.

1232. In addition, the *prior period adjustment* applies only to items of income or expenses that were, or would have been, included in the computation of the *entity elimination profit (or loss)*. In such cases, the adjustment must be treated as an increase or decrease to the *entity elimination profit (or loss)* of the Covered Group. Items of income or expenses that were not, or would not have been, included in the computation of the *entity elimination profit (or loss)* should not be taken into account for purposes of the “prior period adjustment”.

1233. Paragraph 2(d)(iv) provides that the *prior period adjustment* will not apply in the context of a *covered profit allocation transaction*. Subparagraph (c) and paragraph 7 contain specific provisions dealing with adjustments to *entity elimination profit (or loss)* in scenarios where transactions between Group Entities are subject to change in *taxable presence profit amount*, *profit allocation amount*, or *excluded profit amount* in a subsequent period, and these rules will take precedence over the general rules relating to *prior period adjustments*.

Adjustments Relating to Qualifying Reorganisations

1234. Subparagraph (e) provides that Group Entities will make *qualifying reorganisation adjustments* in determining *entity elimination profit (or loss)*. The definition of *qualifying reorganisation adjustment* is included in paragraph 8 and discussion of this adjustment is included from paragraph 1365 of this Explanatory Statement below.

1235. This adjustment will apply in priority to the *integration asset sales adjustment* described below.

Adjustments Relating to Integration Asset Sales

1236. Subparagraph (f) provides that Group Entities will exclude or reduce the amount of gain or loss recognised upon the transfer of an asset between Group Entities in instances where the transfer takes place within 5 years of the transferor Group Entity becoming a Group Entity. In instances where the adjustment under subparagraph (e) also applies to an asset sale that would be subject to this adjustment, the adjustment under subparagraph (e) will be applied in priority and any remaining gain or loss would then be subject to this adjustment. In instances where subparagraph (e) does not apply this adjustment would apply to the whole amount of the gain or loss.

1237. Where the asset transfer occurs within one full year of the equity transferor entity becoming a Group Entity, the adjustment under subparagraph (f) will essentially replicate the *entity elimination profit (or loss)* that would have applied had the asset acquirer Group Entity directly acquired the asset from the original third-party equity transferor. Where the asset transfer occurs between one and five full years after the equity transfer this outcome will be partially replicated.

1238. This adjustment only applies to cases where three conditions are satisfied. First, the asset transfer must occur within five years of the asset transferor Group Entity becoming a Group Entity of the Covered Group. Second, the total gain or loss from the disposal must exceed EUR 5 million. Third, the asset transferor Group Entity must have not previously been a Group Entity of another Covered Group.

1239. As noted in paragraph 1237 above, this adjustment is applied on a phased-out basis to reduce the potential to smooth out any potential cliff edge effect that would otherwise apply if the adjustment were fully applied or disappplied depending on the intervening period between the asset transferor Entity becoming a Group Entity and the asset transfer itself. Where the asset is transferred within one full year of the equity acquisition the related gain or loss will be fully excluded from the *entity elimination profit (or loss)*. Where the asset is transferred more than one full year but less than two full years after the equity acquisition 20% of the gain or loss will be recognised and the remainder will be excluded. Where the asset is transferred more than two full years but less than three full years after the equity acquisition 40% of the gain or loss will be recognised and the remainder will be excluded and so on, until the end of the five-year period following the acquisition of the Group Entity transferring an asset.

1240. The adjustment under subparagraph (f) will only apply where the asset transferor entity was not previously a Group Entity of another Covered Group. This is to ensure that the outcomes achieved by this adjustment are equivalent (or partially equivalent) to a direct asset transfer from one Group to another Group.

Taxable Equity Transaction Adjustments

1241. Subparagraph (g) provides that Group Entities will make *taxable equity transaction adjustments* in determining *entity elimination profit (or loss)*. The definition of *taxable equity transaction adjustments* is included in paragraph 9 and applies to include or exclude income in the Elimination Profit (or Loss) in some

instances. Discussion of this adjustment is included in paragraph 1374 onward of this Explanatory Statement.

Adjustments Relating to Tax Fair Value Treatments

1242. Subparagraph (h) provides that Group Entities will make *tax fair value adjustments* in determining *entity elimination profit (or loss)*. The definition of *tax fair value adjustments* is included in paragraph 10 and applies to include income in the Elimination Profit (or Loss) in some instances. Discussion of this adjustment is included in paragraph 1380 onwards of this Explanatory Statement below.

Adjustments Relating to Main Entities subject to Taxable Presences

1243. Subparagraph (i) provides that Group Entities will make *main entity taxable presence adjustments* in determining *entity elimination profit (or loss)*. The definition of *main entity taxable presence adjustment* is included in paragraph 11 and applies to exclude income from the Elimination Profit (or Loss) in some instances. Discussion of this adjustment is included in paragraph 1386 onwards of this Explanatory Statement below.

Withholding Tax Downward Adjustments

1244. Subparagraph (j) provides a *withholding tax downward adjustment* in determining *entity elimination profit (or loss)*. The adjustment is calculated under paragraph 12 (refer to paragraph 1417 of the Explanatory Statement) and, where applicable, will typically reduce the Elimination Profit (or Loss) of a Jurisdiction where double tax relief has been provided with respect to a Covered Withholding Tax collected by another Jurisdiction on a Covered Payment in a Period. This adjustment effectively provides that a Jurisdiction will not be obliged to eliminate double taxation with respect to an *Amount A relief amount* under Articles 9 through 11 in respect of profits it has already waived its taxing rights over as a result of providing double taxation relief for a Covered Withholding Tax, and that such profits will not either lead to a reduction in the Amount A Profit allocated to a Jurisdiction as a result of a *marketing and distribution profits safe harbour adjustment* under Article 5(2). This is because both Articles 9 through 11 and Article 5 incorporate the defined term *entity elimination profit (or loss)* which is determined under paragraph 2 taking into account the adjustment in subparagraph (j).

Paragraph 3

Taxable presence elimination profit (or loss)

1245. Under paragraph 1, the *elimination profit (or loss)* of a Covered Group for a Period in a Jurisdiction includes the *taxable presence elimination profit (or loss)* of Taxable Presences located in that Jurisdiction. In this way, the determination of *elimination profit (or loss)* recognises that profits of an Entity may be subject to taxation on a net income basis in a Jurisdiction other than the location of the *main entity*. The adjustment seeks to align the Elimination Profit (or Loss) with the corporate income tax base by taking into consideration situations where non-residents are taxed in a Jurisdiction on a net basis through a Taxable Presence.

1246. In all instances where a Group Entity, other than a *regulated financial institution* described in Annex C Section 2(3)(a) or an *extractives entity* described in Annex C Section 3(2)(c), is liable to taxation on a net basis, whether under an income tax or another similar type of tax, in a Jurisdiction other than the Jurisdiction where it is located for the Period, a separate Taxable Presence will be deemed to arise in the former Jurisdiction under Article 2(kk) (see paragraph 132 of this Explanatory Statement).

Subparagraph (a)

1247. Subparagraph (a) provides that the *taxable presence elimination profit (or loss)* of a Taxable Presence for a Period is the sum of two elements. First, subdivision (i) provides for inclusion of an amount equal to the *taxable presence profit amount* of the Taxable Presence for the current Period (i.e., the Period in respect of which the Amount A Tax Return and Common Documentation Package is filed). The *taxable presence profit amount* for the current Period is determined using subparagraph (b). Second, subdivision (ii) requires the inclusion of *taxable profit spreading adjustments* which relate to *tax liability determinations* made during the current Period in respect of *taxable presence profit amounts* derived in prior Periods. How *taxable profit spreading adjustments* should be included is determined using subparagraphs (c) and (d).

Subparagraph (b)

1248. The *taxable presence profit amount* for profits derived in the current Period is calculated in accordance with subparagraph (b). It is the amount of profit determined to be attributable to that Taxable Presence in the Jurisdiction of the location of the Taxable Presence with respect to any fiscal period of that Taxable Presence that ends during the Period. It is the profit amount reflected in the latest *tax liability determination* for that Taxable Presence in its location that was filed or issued at least 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period. Consistent with most corporate income tax systems, therefore, this profit amount shall be understood as the net profit amount that is actually subject to tax in the location of the Taxable Presence.

1249. By determining *taxable presence profit amount* based on actual net profit subject to tax in a Jurisdiction it is not necessary to apply those adjustments that are applied in paragraph 2. Those adjustments are intended to replicate a composite domestic income tax base, whereas relying on the actual profit amount subject to tax for a Taxable Presence will ensure that the actual domestic tax base is reflected. Further, in instances where a Group Entity is deemed to be resident in two jurisdictions under the respective corporate income taxation laws in both jurisdictions, the rules specifying location of a group entity in Paragraph 5 would require that the Group Entity is located in one Jurisdiction (Jurisdiction A) and a Taxable Presence would be deemed to exist under Article 2(kk) in the other resident Jurisdiction (Jurisdiction B) to the extent that taxation is imposed on net profits recognised in that Jurisdiction. The *taxable presence profit amount* in Jurisdiction B with respect to that Taxable Presence would be determined taking into account the amount of profit attributable to that Group Entity for corporate income tax purposes in Jurisdiction B that is effectively taxed in that jurisdiction. In this way, profits of the Entity that are recognised in Jurisdiction B but not subject to tax therein for domestic tax purposes (for example because of an exemption for profits attributable to a permanent establishment outside of Jurisdiction B) are excluded from the *taxable presence profit amount* of the Taxable Presence in Jurisdiction B.

1250. In this context *tax liability determination* is defined in paragraph 13(g). In most instances, the applicable *tax liability determination* would be the original tax return of the Taxable Presence. However, in some instances, it is possible that an amended self-assessed tax return could be filed prior to 60 days before the date on which the Covered Group's Amount A Tax Return and Common Documentation Package for the Period is due and in that case that amended self-assessed tax return would be the applicable *tax liability determination* for the Period. In limited cases, a tax liability assessment could be raised by a tax administration prior to 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period and in that case, that tax liability assessment may be the applicable *tax liability determination* for the Period.

1251. If no *tax liability determination* for any fiscal period of the Taxable Presence that ends during the Period has been made 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period, then the *taxable presence profit amount* will be

deemed to be equal to the amount of profit (or loss) recognised in the Taxable Presence in its original domestic tax return for that fiscal period provided that the original domestic tax return is filed before the date on which the Covered Group's Amount A Tax Return and Common Documentation Package for the Period is due. Alternatively, where no domestic tax return is filed and no other *tax liability determination* is made for that Taxable Presence before the date on which the Covered Group's Amount A Tax Return and Common Documentation Package for the Period is due the amount will be zero.

1252. For the purpose of assessing whether a *tax liability determination* exists in relation to a *taxable presence*, a determination in the location of the Taxable Presence that satisfies the requirements of paragraph 13(g) and relates to a Qualifying Domestic Minimum Top-Up Tax or similar tax will be considered to be a *tax liability determination* for the purpose of determining the *taxable presence profit amount* only in cases where no other corporate income tax applies in the Jurisdiction where that Taxable Presence is located.

Subparagraph (c)

1253. Subparagraph (c) includes changes in the *taxable presence profit amount* with respect to a Taxable Presence during the Period that relate to profits or losses originally recognised in a prior Period. This subparagraph applies with respect to changes in a *tax liability determination* with respect to a Taxable Presence that existed in a prior Period in which the Group was a Covered Group. It also applies in instances where a *tax liability determination* has been made in the Period that relates to profits attributable to a Taxable Presence that were derived in a Period when no *taxable presence profit amount* was originally recognised for that Taxable Presence provided the Group was a Covered Group in that Period.

1254. Subparagraph (c) provides that an amount will only be recognised in the Period under subparagraph (c) if at least 75 per cent of the additional tax liability or tax refund associated with the applicable *tax liability determination* is paid before the end of that Period.

1255. Where the taxpayer or tax administration has made no or insufficient payment following a *tax liability determination*, including in cases where it has lodged an appeal against the tax assessment or initiated compliance proceedings, the entire amount of the change in *taxable presence profit amount* will not (yet) be taken into account for the purpose of determining the *taxable presence elimination profit (or loss)*. Once at least 75 per cent of the additional tax or refund amount is paid in aggregate, for example in a case where the taxpayer decides to accept the tax assessment or loses the appeal and is compelled to make payment, the change in *taxable presence profit amount* from the *tax liability determination* must be recognised in that Period. A *tax liability determination* can therefore only create a potential obligation to relieve double taxation for purposes of Amount A where at least 75 per cent of the additional tax is paid or at least 75 per cent of the refund is paid.

Box 24. Example – Taxable presence elimination profit or (loss)

- For example the Amount A Tax Return and Common Documentation Package for the year ended 31 December 2029 was due on 31 December 2030. The Covered Group filed a corporate income tax return on 30 September 2030 for the year ended 31 December 2029 in respect of a Taxable Presence in Jurisdiction A (where the Taxable Presence was located) attributing a profit of EUR 1 000 to that Taxable Presence, the *taxable presence profit amount* of EUR 1 000 for the Taxable Presence in Jurisdiction A would be recognised in the 2029

Amount A Tax Return and Common Documentation Package filing by virtue of subparagraph (b).

- In 2032, the tax authority of Jurisdiction A made an assessment imposing an upwards adjustment of EUR 3 000 to the profit allocated to the Taxable Presence relating to 2029 (so that the total profit attributable to the Taxable Presence in Jurisdiction A in 2029 was EUR 4 000), giving rise to an additional EUR 300 of corporate income tax in Jurisdiction A (assuming a corporate income tax rate of 10%). This would result in an increase of the *taxable presence profit amount* from EUR 1 000 to EUR 4 000 in 2032 with respect to the profits derived by the Taxable Presence in 2029. If the Covered Group did not make any payment during 2032, there would be no *taxable profit spreading adjustment* of the Taxable Presence relating to 2029 Period that would be recognised in the 2032 Period.
- Similarly, if the Covered Group made payment of EUR 100 in respect of the EUR 300 tax liability during 2032, no *taxable profit spreading adjustment* of the Taxable Presence for the 2029 Period would be recognised in the 2032 Amount A Tax Return and Common Documentation Package since the payment made did not represent at least 75% of the additional tax assessed.
- However, if during 2032, the Covered Group paid EUR 250 in respect of the EUR 300 tax liability imposed, the 75% threshold would be met and the Covered Group would be required to recognise a *taxable profit spreading adjustment* of the Taxable Presence in the 2032 Period in the amount of EUR 3 000. This would be recognised in one Period only because the change in *taxable presence profit amount* is less than EUR 5 million and therefore paragraph 3(c)(i) of this Section applies.
- If in circumstances where the Covered Group made the payment of EUR 250 in 2032, the taxpayer appealed the increased assessment and in 2033 the courts of Jurisdiction A determined that the total profit attributable to the Taxable Presence for 2029 should have been EUR 3 000, a reduction in the *taxable presence profit amount* of EUR 1 000 related to the Taxable Presence for 2029 would again be observed and a *taxable presence spreading adjustment* would be made provided that the 75% payment requirement was satisfied. In determining whether the tax authority had paid 75% of the refund in this case both the outstanding amount owed by the taxpayer in relation to the prior *tax liability determination* and any payment by the tax administration would be taken into account. In this case, EUR 50 was already outstanding so provided that at least EUR 25 is paid from the tax administration to the taxpayer before the end of 2033, that change should be recognised in the Amount A Tax Return and Common Documentation Package for 2033 as a *taxable profit spreading adjustment*.

1256. In practice, it may often be the case that an upward adjustment to profits of a Taxable Presence is made in respect of more than one fiscal year, e.g., the tax authority of the Jurisdiction of the location of the Taxable Presence may consider that the profits of the Taxable Presence were understated for three years and adjust accordingly. In those cases, the combined adjustment is treated in aggregate provided that all periods covered by the *tax liability determination* related to periods where the Group was a Covered Group.

1257. Where the above described conditions with respect to subparagraph 3(c) are satisfied (i.e., a *tax liability determination* is made in respect of a Taxable Presence that changes the *taxable presence profit amount* recognised in a prior Period in respect of that Taxable Presence or establishes a *taxable presence*

profit amount with respect to a Taxable Presence in a prior Period not previously recognised and at least 75 per cent of the additional tax or refund resulting from the *tax liability determination* is paid), the *tax liability determination* will be taken into account as a “taxable profit spreading adjustment” that may be subject to spreading over multiple future Periods. Applicable spreading is determined in one of three ways depending on the circumstances of the change, as clarified in subdivisions (i) through (iii).

1258. Subdivision (i) provides that if the change in the *taxable presence profit amount* is less than EUR 5 million, the entire change shall be taken into account in the current Period. This outcome will apply regardless of whether *taxable profit spreading adjustments* relating to that Taxable Presence are still being recognised in the current Period from a *tax liability determination* in a prior Period which might apply where a prior change in *taxable presence profit amount* of at least EUR 5 million that is subject to spreading under subdivision (ii) occurred in the previous Period whereas the current change is less than EUR 5 million.

1259. Subdivision (ii) provides that if the change in the *taxable presence profit amount* is greater than EUR 5 million, the change shall be taken into account partially in the current Period and partially in future Periods.

1260. Subdivision (ii)(A) applies in cases where there has been a previous adjustment under subdivision (ii) in the Jurisdiction in respect of the same Taxable Presence and where the full *taxable profit spreading adjustment* has not yet been taken into account. In that case, that new change in the *taxable presence profit amount* is combined with the remaining adjustment in respect of the prior Period that has not yet been included in determining the *taxable presence elimination profit (or loss)* for any Period. The net amount is spread equally over a number of Periods beginning with the current Period and consisting of the greater of:

- three total Periods;
- the number of Periods to which the determination giving rise to the current change relates; and
- the number of Periods over which the remaining *taxable profit spreading adjustment* from the prior change are spread.

1261. For example, if an upward adjustment of EUR 45 million was made by Jurisdiction A in 2028 to the profits of a Taxable Presence related to the tax years 2022 to 2026, the *taxable profit spreading adjustment* would be made over five Periods, commencing in 2028 (assuming that at least 75% of the additional tax was paid in 2028). If, three years later in 2031, following a mutual agreement procedure, a subsequent downward adjustment of EUR 5 million was made by Jurisdiction A in respect of the profits of the same Taxable Presence for the 2022 to 2026 tax years (assuming that at least 75% of the additional tax was refunded in 2031), the net amount under subparagraph (b) would be EUR 13 million (i.e. EUR 45 million less three years of spreading adjustments of EUR 9 million each recognised in 2028, 2029 and 2030, less the new EUR 5 million adjustment). This would be spread equally across five Periods. Five is the number of Periods to which the determination giving rise to the 2031 change relates (2022-2026). That is greater than the default three Periods and the number of Periods remaining for the 2028 adjustment (two Periods)).

1262. For purposes of applying the rules in subdivision (ii), the number of Periods to which the determination giving rise to the current change relates should be interpreted having regard to the Explanatory Statement with regard to the definition of *tax liability determination* (see paragraph 1465).

1263. Commonly the number of Periods impacted by both the current change in *taxable presence profit amount* and the previously recognised *taxable presence profit amount* that has not yet been fully recognised will be the same. This might be because the second change relates to a challenge to an original

tax assessment and the scope of both determinations is the same. Where this is the case, the re-setting of the applicable spreading period will result in a prolonging of the number of Periods over which the original adjustment is recognised.

1264. If the upward adjustment of EUR 35 million was made by Jurisdiction A in 2030 to the profits of a Taxable Presence in respect of the tax years 2022 to 2028, the *taxable profit spreading adjustment* would be made over seven Periods, commencing in 2030 (assuming that at least 75% of the additional tax was paid in 2030). If, the taxpayer appealed the assessments made in respect of 2022 to 2024 and in 2033, the courts of Jurisdiction A decided that the assessment made in respect of each of those tax years should be reduced by EUR 2 million, the new adjustment would exceed EUR 5 million and the amount of the current change and any remaining taxable profit spreading adjustment from the prior change would be EUR 14 million (i.e. EUR 35 million less three years of spreading adjustments of EUR 5 million each recognised in 2030, 2031 and 2032, less the new EUR 6 million adjustment). This would be spread equally across four Periods (assuming the refund is paid in 2033). Four is the number of Periods remaining for the 2030 adjustment. That is greater than the default three Periods and the number of Periods to which the current adjustment relates (three Periods)).

1265. Subdivision (ii)(B) applies in all other cases not covered by clause (A) where the change in the *taxable presence profit amount* is greater than EUR 5 million. That would include, for example, where there has been no previous *taxable profit spreading adjustments* in the Jurisdiction in respect of the same Taxable Presence or there has been such an adjustment but the full amount of that prior adjustment has already been taken into account. In those cases the adjustment is spread equally across a term beginning with the current Period and consisting of the greater of three Periods; and the number of Periods to which the determination giving rise to a change in the *taxable presence profit amount* relates.

1266. For example, if Jurisdiction A made an upward adjustment exceeding EUR 5 million to the profits of a Taxable Presence in 2030 in respect of the 2028 tax year and no previous adjustment had been made by Jurisdiction A with respect to the profits of that Taxable Presence, clause (B) would operate to spread the impact of that adjustment over three Periods (assuming that at least 75% of the additional tax was paid in 2030). If Jurisdiction A made a subsequent downward adjustment to the profits of the same Taxable Presence in 2034 (by which time the 2030 adjustment would have been fully included), clause (B) would again apply to spread the new adjustment in isolation over three Periods (as the 2030 adjustment would be fully recognised at that time) (assuming that at least 75% of the tax refund was paid in 2034).

1267. Subdivision (iii) provides that if the *main entity* that has the Taxable Presence in respect of which an adjustment under subdivision (ii) has been made leaves the Covered Group in a Period and the full amount of a *taxable profit spreading adjustment* has not yet been taken into account, the remaining amount of the adjustment that has not been spread across prior Periods must be included in the *taxable presence elimination profit (or loss)* in the Period that the *main entity* leaves the Covered Group. If the Taxable Presence that is subject to a *taxable profit spreading adjustment* ceases to exist, then the requirement provided in subdivision (iii) will be deemed to be satisfied.

1268. For example, if an upward adjustment under subparagraph (b) of EUR 50 million was made by Jurisdiction A in 2028 to the profits of a Taxable Presence in respect of the 2022 to 2026 Periods and that adjustment was spread over five Periods, an adjustment of EUR 10 million would be made each year commencing in 2028 (assuming that at least 75% of the additional tax was paid in 2028). If, two years later in 2030 the *main entity* with the Taxable Presence leaves the Covered Group, the remaining amount of the adjustment that has not been spread across prior Periods would be EUR 30 million (being EUR 50 million less EUR 10 million applied in 2028 and less EUR 10 million applied in 2029). Under subdivision (iii), that EUR 30 million must be included in the *taxable presence elimination profit (or loss)* for 2030.

Subparagraph (d)

1269. Subparagraph (d) is designed to deal with cases where a Covered Group comes in and out of scope of Amount A. It is intended to ensure that *tax liability determinations* with respect to Taxable Presences that relate to income or expenses recognised in the Entity Financial Accounting Profit (or Loss) of the *main entity* in Periods when the Group was in scope of Amount A that are made during Periods when the Group is not in-scope of Amount A are taken into account when the Group subsequently comes back into scope of Amount A. The provision will not apply if the most recent change in *taxable presence profit amount* occurred more than two Periods before the Group comes back into scope.

1270. With respect to a Taxable Presence in a prior Period, a change in the *taxable presence profit amount* will be recognised in respect of that Taxable Presence in the Period where conditions in subdivisions (i) and (ii) are satisfied.

1271. The first condition is that the Group was not a Covered Group in the immediately preceding Period. The second condition is that the most recent change in *taxable presence profit amount* prior to the Period with respect to that Taxable Presence resulting from a *tax liability determination* during a Period when the Group was not a Covered Group and less than two years before the beginning of the Period. In those cases, the *taxable presence profit amount* in the Period will be deemed equal to the profit (or loss) amount for that Taxable Presence in the latest *tax liability determination* prior to the end of the current Period, less the profit (or loss) amount recognised in the latest *tax liability determination* with respect to that Taxable Presence during a prior Period where the Group was a Covered Group.

1272. For example, a Group that was in-scope of Amount A in 2024 recognised a Taxable Presence in Jurisdiction A with a profit of EUR 100 million in 2024. The Group fell out of scope of Amount A in 2025. In 2030, the tax authority in Jurisdiction A made an upward adjustment of EUR 30 million to the profit of the Taxable Presence in Jurisdiction A for 2028. If the Group came back into scope of Amount A in 2031 (less than two Periods after the change in *taxable presence profit amount* took place) the Covered Group would recognise an increase in the *taxable presence profit amount* for the Taxable Presence in Jurisdiction A with respect to 2028 of EUR 30 million (assuming that at least 75% of the additional tax was paid). This adjustment would be subject to spreading treatment as described above commencing from 2031.

1273. In addition, there could be situations where both subparagraphs (c) and (d) apply to a Taxable Presence in a given Period. In such a case, the net of the amounts determined under those two subparagraphs would be considered to be the relevant *taxable presence profit amount*. Paragraph 1573 of the Explanatory Statement provides a description of how these provisions would apply in the context of a *withholding tax upward adjustment* and the same concepts apply in this context.

Paragraph 4

Application to Flow-through entities

1274. Paragraph 4 ensures that for purposes of computing the Elimination Profit (or Loss) of a Group Entity and the *taxable presence elimination profit (or loss)* of Taxable Presence for a Covered Group for a Period, the Entity Financial Accounting Profit (or Loss) of a *flow-through entity* is allocated to the Group Entities and any Taxable Presences that are liable to corporate income tax on such profit (or loss) in accordance with international and domestic tax laws.

1275. A *flow-through entity* will typically prepare entity financial statements that are incorporated in the Consolidated Financial Statements of the Covered Group. However, the *flow-through entity* is not liable to tax on its result because it is treated as fiscally transparent with respect to its income, expenditure, profit

or loss in the Jurisdiction where it was created; this Jurisdiction will for domestic tax purposes allocate the *flow-through entity's* results to its owners in proportion to their Specified Equity Interests.

1276. A *flow-through entity* is defined in subparagraph (b) as a Group Entity that is fiscally transparent with respect to its income, expenditure, profit or loss in the Jurisdiction where it was created, unless it is tax resident and liable to a covered tax on its income or profit in another Jurisdiction. Subparagraph (e) clarifies that an entity is fiscally transparent in a Jurisdiction if that Jurisdiction treats the income, expenditure, profit or loss of that Entity as if it is derived or incurred by its owners in proportion to their Specified Equity Interests. If the Group Entity is tax resident and liable to a *covered tax* on its income or profit in another Jurisdiction, the Entity will be located in the Jurisdiction imposing tax under paragraph 5(a)(i) and the *entity elimination profit (or loss)* of the *flow-through entity* is allocated to that Jurisdiction; the Group Entity will then not qualify as a *flow-through entity* under subparagraph (b).

1277. To recognise that Entity Financial Accounting Profit (or Loss) of a *flow-through entity* may be subject to tax in a Taxable Presence (and the *main entity* may receive double taxation relief), subparagraph (a) provides that the relevant part of the Elimination Profit (or Loss) of the *flow-through entity* is first reduced by the amount of profit that is subject to adjustment under paragraph 11, and the remaining part is allocated to each Group Entity that owns a Specified Equity Interest that carries rights to the profits, capital or reserves of the *flow-through entity* in proportion to their Specified Equity Interests (subject to the limitation identified below).

1278. Subparagraph (a)(ii) and (iii) then allocate the Entity Financial Accounting Profit (or Loss) to the Group Entities owning a Specified Equity Interest in the *flow-through entity* to the extent that the *flow-through entity* qualifies as a *tax transparent entity* (i.e., is not a *reverse hybrid entity*), as defined in subparagraph (c). This means that where the Jurisdiction in which an owner of Specified Equity Interests in the *flow-through entity* considers the entity as fiscally transparent, this owner will be allocated the Entity Financial Accounting Profit (or Loss) in proportion to its Specified Equity Interests. Where the Jurisdiction of an owner of a Specified Equity Interest in the *flow-through entity* does not consider the entity fiscally transparent, this owner will not be allocated any Entity Financial Accounting Profit (or Loss). The profit (or loss) of the *flow-through entity* attributable to that owner's Specified Equity Interests (after application of subparagraph (a)(i)) is instead attributed to the Jurisdiction where the *flow-through entity* is located under paragraph 5(a) – i.e., the Jurisdiction in which it was created. This follows from subparagraph (a)(iv).

1279. Subparagraph (a)(ii) and (iii) require then in cases where an Ultimate Parent Entity qualifies as a *flow-through entity*, its *entity elimination profit (or loss)* should not be allocated to investors owning a Specified Equity Interest in that Ultimate Parent Entity that is a *flow-through entity*. The full *entity elimination profit (or loss)* of the Ultimate Parent Entity *flow-through entity* should then be allocated to the Jurisdiction where that entity was created, save for any profit (or loss) that is allocatable to Taxable Presences in other Jurisdictions. Similarly, in the case of third-party investors holding Specified Equity Interests in a Group Entity that is a *flow-through entity* and not the Ultimate Parent Entity, profits will not be attributed to such third-party investors. The reason for these treatments is to ensure that profits included in the Adjusted Profit Before Tax are not permitted to escape the Elimination Profit (or Loss) thereby ensuring alignment of the tax bases to the extent possible.

1280. Subparagraph (b) contains the definitions of the term *flow-through entity* that is relevant throughout this paragraph and means a Group Entity that is fiscally transparent with respect to its income, expenditure, profit or loss in the Jurisdiction where it was created unless it is tax resident and liable to a covered tax on its income or profit in another Jurisdiction.

1281. The characterisation of a flow through entity as either a *tax transparent entity* or a reverse hybrid entity will be determined with respect to each investor holding equity interests in the flow through entity,

based on whether the flow through entity is fiscally transparent in the Jurisdiction in which that owner is located. For example, where a *flow-through entity* has Entity Financial Accounting Profit (or Loss) of 100 after application of subparagraph (a)(i), and the *flow-through entity* is half owned by a Group Entity in jurisdiction A where that *flow through entity* is considered to be fiscally transparent and half owned by a Group Entity in Jurisdiction B where that *flow through entity* is not considered to be fiscally transparent, the *flow through entity* will be considered to be partially a *tax transparent entity* and partially a *reverse hybrid entity*. On this basis, subparagraph (a)(iii) will apply and 50 of Entity Financial Accounting Profit (or Loss) will be recognised in the *flow-through entity* and 50 of Entity Financial Accounting Profit (or Loss) will be recognised in the investor Group Entity in Jurisdiction A.

1282. Subparagraph (c) provides that *flow-through entity* is a “tax transparent entity” with respect to its income, expenditure, profit or loss to the extent that it is fiscally transparent in the Jurisdiction in which its owner or owners are located. Subparagraph (d) provides that a *flow-through entity* is a *reverse hybrid entity* with respect to its income, expenditure, profit or loss to the extent that it is not fiscally transparent in the Jurisdiction in which its owner or owners are located.

1283. To aid in the interpretation of subparagraphs (b) through (d), subparagraph (e) provides that an Entity is treated as fiscally transparent under the laws of a Jurisdiction, if that Jurisdiction treats the income, expenditure, profit or loss of that Entity as if it were derived or incurred by the direct or indirect owners of that Entity in proportion to their interest in that Entity.

1284. Subparagraph (f) is a deeming provision that treats a Group Entity as a *flow-through entity* and a *tax transparent entity* if such an Entity has no tax residency and is not subject to a *covered tax* in any Jurisdiction, to the extent that conditions in subdivisions (i) through (iii) are met. The most common case covered by this provision is where a Group Entity, with no tax residency, is created in a Jurisdiction with no corporate income tax and its owners treat that Entity as fiscally transparent. Without subparagraph (f), this scenario would not be covered by subparagraph (a) because these Entities are not fiscally transparent in the Jurisdiction where they are created, as they are not subject to a corporate income tax legislation that treats their income, expenditure, profit or loss as derived or incurred by its owners.

1285. Subparagraph (f) is only triggered if several conditions are met. First, the Group Entity must not have a tax residence and is not subject to a *covered tax* on the basis of its place of management, place of incorporation, place of constitution, place of carrying on business, place of residence of controlling shareholders or similar criteria in any Jurisdiction. Second, the Jurisdiction of the Group Entity’s owners must treat the Entity as fiscally transparent. Third, the Group Entity must not have a place of business in the Jurisdiction where it was created. Lastly, its income, expenditure, profit or loss must not be attributable to a Taxable Presence.

1286. Similar to subparagraph (a), subparagraph (f) only applies in respect of the income, expenditure, profit or loss of the Group Entity to the extent that the conditions in subdivisions (i) through (iii) are met. Thus, a Group Entity could be treated as a *flow-through entity* and a *tax transparent entity*, and at the same time, treated as an Entity that is not a *flow-through entity*.

1287. Consider the example where C Co is a Group Entity created in Jurisdiction C, a Jurisdiction with no corporate income tax. C Co has no place of business in Country C and its income is not attributable to a Taxable Presence. The equity interests in C Co are equally distributed among A Co and B Co, which are Group Entities in the same Covered Group. A Co is a resident of Jurisdiction A, which treats C Co as fiscally transparent. B Co is a resident of Jurisdiction B, which does not treat C Co as fiscally transparent. In this case, only 50% of the Entity Financial Accounting Profit (or Loss) of C Co is treated as belonging to a *tax transparent entity*, and will be allocated to A Co. The remaining 50% of the Entity Financial Accounting

Profit (or Loss) of C Co is taken into account in the *entity elimination profit (or loss)* of C Co in Jurisdiction C.

Paragraph 5

Location of a Group Entity and a Taxable Presence

1288. Paragraph 5 sets out the rules that determine the location of a Group Entity and a Taxable Presence for purposes of the Convention. Determining the location of a Group Entity and a Taxable Presence is important for the purpose of determining both Elimination Profit (or Loss) and Jurisdictional Depreciation and Payroll of a Covered Group for a Period in a Jurisdiction. Paragraph 5 applies only for purposes of the Convention and does not carry any wider implications for the application of domestic law or tax treaty provisions, such as those dealing with tax residence and the taxation of income arising in a Jurisdiction.

1289. The approach to determining the location of a Group Entity or Taxable Presence is described in subparagraphs (a) through (c), including tiebreaker rules in subparagraph (c) for the situation in which a Group Entity is located in more than one Jurisdiction. Subparagraph (d) determines how a Group Entity's *entity elimination profit (or loss)* and *entity depreciation and entity payroll* should be determined where the Entity moved its location during a Period.

1290. The principle underlying the rules for determining the location of a Group Entity or Taxable Presence is to follow their treatment under domestic tax law whenever possible. In most cases, a Group Entity will have its location in the Jurisdiction where the Entity is a tax resident. If, however, multiple Jurisdictions consider the Group Entity to be tax resident in their Jurisdiction, the location of the Group Entity will be determined based on tiebreaker rules contained in subparagraph (c). If neither of these tiebreakers lead to a decisive outcome, the Group Entity will be located in the Jurisdiction where the Entity was created. A Taxable Presence is located in the Jurisdiction where it is liable to taxation on a net basis.

Subparagraph (a)

1291. Subparagraph (a) is the default rule for determining the location of a Group Entity that is not a *flow-through entity*. Subdivision (i) states that a Group Entity is located in the Jurisdiction where liable to tax based on its place of management, place of creation, or other similar criteria. In this context, other similar criteria could include considerations such as place of residence of controlling shareholders, place of head or main office or other criteria. Whether a Group Entity is a subject to tax in a Jurisdiction depends on the domestic law of that Jurisdiction. A Group Entity is defined for purposes of the Convention to refer to a juridical person or arrangement that prepares separate financial accounts, and subparagraph (a) therefore does not require the Entity to be a legal person.

1292. The reference to “place of management, place of incorporation, place of constitution, place of carrying on business, place of residence of controlling shareholders, place of head or main office” are non-exhaustive examples of criteria used by Jurisdictions in their domestic tax residency rules. The words “or similar criteria” allows for other criteria used in domestic tax residency rules to be considered, such as domicile and registration.

1293. A Group Entity will be considered located in a Jurisdiction under subdivision (i) if it is a tax resident in that Jurisdiction according to national or federal law only. For example, a Group Entity may be treated as a *flow-through entity* for purposes of federal or national tax law but considered as a tax resident under local or sub-national tax law. In these cases, the Group Entity would not be liable to tax in that Jurisdiction within the meaning of subdivision (i).

1294. Some Jurisdictions may permit a Group Entity organised outside of the Jurisdiction to make an election to claim tax residency in that Jurisdiction. Such an election, on its own, is not determinative of the Entity's location for purposes of subdivision (i) and is not considered "other similar criteria".

1295. Subdivision (ii) provides that an Entity will be considered to be located in the Jurisdiction where it was created where there is no Jurisdiction that considers the Group Entity tax resident under the criteria included in subdivision (i). This could apply, for instance, to Group Entities organised in Jurisdictions without a corporate income tax system. A Group Entity that is a *flow-through entity* as defined in paragraph 4(b) will likewise be located in the Jurisdiction where it was created.

Subparagraph (b)

1296. Subparagraph (b) determines the location of a Taxable Presence. This provision should be read in conjunction with the other provisions of the Convention dealing with Taxable Presences such as the definitions of *main entity* and Taxable Presence in paragraph 13(i) and (r).

1297. Where a Jurisdiction other than a Jurisdiction where the Group Entity is located taxes a presence of that Group Entity located in another Jurisdiction on a net basis, that Taxable Presence will be located in the first Jurisdiction under subparagraph (b). Since the definition of Taxable Presence aligns with the domestic law of the Jurisdiction imposing the tax, regardless of the nexus requirements imposed by that domestic law, a Taxable Presence could be located in a Jurisdiction where the Group Entity has no physical presence.

Subparagraph (c)

1298. Subparagraph (c) addresses the case where a Group Entity is located in two or more Jurisdictions after application of subdivision (i) (i.e. qualifies as a tax resident in more than one Jurisdiction). For example, a Group Entity may be incorporated in one Jurisdiction and have its place of effective management in another and be treated as tax resident in both Jurisdictions under the respective domestic definitions of tax residence.

1299. Subparagraph (c) therefore contains tiebreaker rules for determining the location of a dual-resident Group Entity for purposes of the Convention. As a result of these rules, the Group Entity is treated as being located in one Jurisdiction and having a Taxable Presence in the resident Jurisdiction in which the Group Entity is not located.

1300. Subparagraph (c) addresses two scenarios: (i) situations in which one or more applicable *covered tax treaties* may resolve the residency conflict; and (ii) situations where the residency conflict is not resolved under a *covered tax treaty*. These situations will be addressed in turn.

1301. The tiebreaker rule under paragraph 5 shall not have any implication for the residence or location of a company or permanent establishment determined under bilateral tax treaties and domestic laws.

Applicable covered tax treaty in force

1302. Subparagraph (c) first seeks to align the applicable location of a Group Entity for purposes of the Convention with the tax residency concept included in the tax treaties relevant to the taxation of the Entity. This tax treaty tiebreaker is applicable where there is a *covered tax treaty* in force and in effect between the Jurisdictions in which the Group Entity is located under subdivision (i), which includes an applicable residency tiebreaker. The term "covered tax treaty" is defined in paragraph 13(b).

1303. An applicable *covered tax treaty* may lead to two possible outcomes where two Jurisdictions consider a Group Entity a tax resident. First, the relevant *covered tax treaty* may resolve the dual residence (for example, by virtue of a provision similar to Article 4(3) of the OECD Model. The Convention will then follow the outcome of the *covered tax treaty*, irrespective of the type of tiebreaker rule contained in the relevant *covered tax treaty*. The tiebreaker rules that may be applicable under the relevant treaty include provisions giving priority to the place of effective management or provisions requiring dual residence issues to be resolved through an agreement between the competent authorities.

1304. Alternatively, the relevant *covered tax treaty* may not resolve the dual residence conflict. For instance, where the *covered tax treaty* provides that the Group Entity's residence must be determined by mutual agreement, the dual residency remains unresolved where the mutual agreement procedure has not yet been initiated or no agreement has been reached. In these cases, subdivisions (i) and (ii) will apply as if there is no applicable tax treaty in force. The same applies where there is a dispute between the relevant competent authorities in respect of the Group Entity's tax residency under the *covered tax treaty*.

1305. Subparagraph (c) would also apply where the Group Entity would be located in three (or more) Jurisdictions under subparagraph (a)(i). In that case, the tax residency conflict may be resolved under the tax treaty tiebreaker where the *covered tax treaties* in effect between the different relevant Jurisdictions provide one clear place of tax residency.

No applicable covered tax treaty in force

1306. Subparagraph (c)(i) and (ii) provide two tiebreaker rules for situations in which the dual residency conflict is not resolved by an applicable *covered tax treaty*.

1307. The first tiebreaker included in subparagraph (c)(i) provides that the Group Entity shall be located in the Jurisdiction where it paid the greater amount of *covered taxes* for the fiscal year. This rule only considers the amount of *covered taxes* paid in the Jurisdictions where the Group Entity would be located under subparagraph (a)(i). It does not take into account any *covered taxes* imposed by other Jurisdictions, even if the Group Entity benefits from a foreign tax credit in the Jurisdiction where it could be located. The term "covered taxes" is defined in paragraph 13(c).

1308. Subparagraph (c)(i) refers to the "covered taxes paid" in both Jurisdictions for the fiscal year ending in the Period. In this context, "taxes paid" refers to the *covered taxes* that are paid or due to be paid in each Jurisdiction for the fiscal year ending in the Period. This information is taken from the tax returns that the Group Entity files or will file in each Jurisdiction. Where the taxable year is different to the fiscal year, then the amount of taxes should be calculated on a pro rata basis and assigned to the number of months that correspond to the fiscal year. Consider the situation where a Group Entity paid 120 of taxes for the first taxable year and 60 for the second taxable year. The taxable year runs from July 1 to June 30 and the Period equals the calendar year. In this case, the Period runs between two taxable years. The amount of tax paid for the Period would be 90 $[(120/12) \times 6 + (60/12) \times 6]$.

1309. Where subparagraph (c)(i) does not yield an outcome because the amount of *covered taxes* paid in both Jurisdictions is the same or zero, subparagraph (c)(ii) provides that the Group Entity shall be considered to be located in the Jurisdiction where it was created.

Subparagraph (d)

1310. The provisions of subparagraphs (a) and (c) shall apply for each Period separately. This means that a Group Entity can be located in different Jurisdictions in different Periods depending on the outcome of the main residency rule and various tiebreaker rules. A Group Entity may, for instance, be located in a different Jurisdiction than the preceding year under subparagraph (c) because a *covered tax treaty* comes

into force, or an agreement is reached between competent authorities on the tax residency of the Group Entity.

1311. However, the location of a Group Entity may also change during the Period, in which case subparagraph (d) determines that the Group Entity's *entity elimination profit (or loss)* and *entity depreciation and entity payroll* will be determined for each of those Jurisdictions by reference to the duration of the Period that the Group Entity was located in the Jurisdiction.

Subparagraph (e)

1312. Subparagraph (e) applies in scenarios where the outcome of a MAP retroactively changes the location of a Group Entity for prior Periods where the Group was a Covered Group and the Entity was a Group Entity. In such cases it is necessary to attribute the Elimination Profit (or Loss) in prior periods subject to the MAP determination to the new location and to provide a downward adjustment in the previous location. Under this approach the net total Elimination Profit (or Loss) recognised with respect to the Group Entity will replicate the amount that would have been recognised if the updated location and *taxable profit* amounts outcome had been recognised in the original Amount A filing.

1313. In order to achieve this outcome, subparagraph (e) does not change the location of such a Group Entity retroactively for prior Period(s) for purposes of Amount A, but instead recognises an adjustment in the current Period, as well as in future spreading Periods if applicable.

1314. In a first step, subdivision (i) deems two Taxable Presences to exist in the current filing Period. One Taxable Presence is recognised in the location where the Group Entity was located as identified in the Amount A Tax Return and Common Documentation Package for the Period(s) subject to the MAP determination. Another Taxable Presence is recognised in the location where the Group Entity was deemed to be located under the MAP for those Period(s).

1315. In a second step, these deemed Taxable Presences are used as a vehicle to align the Elimination Profit (or Loss) with the MAP outcome. Subdivision (ii) aligns the Elimination Profit (or Loss) in the location identified in the Amount A Tax Return and Common Documentation Package in the prior Period(s) by subtracting, under clause (A), an amount equal to the *entity elimination profit (or loss)* of that Group Entity recognised in before the MAP was concluded in the prior Period(s) in which the Group was a Covered Group and the Entity was a Group Entity from the *taxable presence elimination profit (or loss)* of the deemed Taxable Presence. Clause (B) then provides that the amount recognised in clause (A) is then subject to spreading in accordance with provisions contained in paragraph 3(c) with respect to the net adjustment determined under clause (A) for all Periods subject to the determination.

1316. Subdivision (iii) aligns the Elimination Profit (or Loss) in the location of the Group Entity as determined under the MAP by defining the deemed *taxable presence elimination profit (or loss)* in this Jurisdiction, under clause (A), as the *entity elimination profit (or loss)* that would have been recognised for that entity in this location in accordance with the determination made under the MAP in the prior Period(s) where the Group was a Covered Group and the Entity was a Group Entity and assuming spreading adjustments did not apply. Clause (B) then provides that the amount recognised in clause (A) will be subject to spreading in accordance with provisions contained in paragraph 3(c) with respect to the net adjustment determined under clause (A) for all Periods subject to the determination.

1317. Any change to taxable income recognised in Taxable Presences in connection with such a MAP determination would be resolved under paragraph 3 and not under this subparagraph. Consider a case where, according to the Amount A Tax Return and Common Documentation Package *in a prior Period*, a Covered Group had a Group Entity in Jurisdiction A and a Taxable Presence in Jurisdiction B. However,

under a MAP determination it is resolved that in fact the Group Entity was located in Jurisdiction B and a Taxable Presence was recognised in Jurisdiction A. In such cases, the profits previously attributed to the Taxable Presence in B will be subject to a downward adjustment in Jurisdiction B in the Period (and subsequent spreading periods) in accordance with paragraph 3, and newly recognised profits in the Taxable Presence in Jurisdiction A will be subject to an upward adjustment in Jurisdiction A in the Period (and subsequent spreading periods) in accordance with paragraph 3.

Paragraph 6

Relevant elimination net losses (General)

1318. In computing its Elimination Profit (or Loss) in a Jurisdiction for a Period, a Covered Group must take account of any historic unrelieved losses incurred in that Jurisdiction that are available for carry-forward. The definition of Elimination Profit (or Loss) in a Jurisdiction, set out in paragraph 1, thus provides for the deduction of “relevant elimination net losses”. The rules on *relevant elimination net losses* generally align with the framework developed for purposes of carrying forward losses in computing the Covered Group’s Adjusted Profit Before Tax (Annex B Section 2), adapted as necessary to reflect the jurisdictional context of Elimination Profit (or Loss).

1319. *Relevant elimination net losses* are a jurisdictional attribute of the Covered Group. They are calculated and reported through a single account in each Jurisdiction and are administered separately from any existing domestic loss carry-forward regime applicable to the Covered Group and its Group Entities (for documentation and reporting obligations, see Part V Section 1 (Administration)).

1320. Subparagraph (a) in combination with paragraph 1, provides that *relevant elimination net losses* are deducted in the chronological order of the prior period(s) to which they correspond. Moreover, *relevant elimination net losses* are deducted only up to the amount, if greater than zero, of the sum of the *entity elimination profit (or loss)* of each Group Entity and the *taxable presence elimination profit (or loss)* of each Taxable Presence in that Jurisdiction for the Period. This means that any excess amount of *relevant elimination net losses* in a Jurisdiction must be carried forward to the subsequent Period, and potentially be deducted in that Period if the other relevant conditions are met (e.g. time limitations related to eligible elimination prior periods). The deduction and carry-forward of *relevant elimination net losses* (including those that are constituted by *transferred elimination losses*, if the required conditions are met) is mandatory.

1321. Where a Covered Group falls out of scope of the Convention in a Period and then comes into scope again under Article 3 in a subsequent Period, the mechanism to compute, deduct and carry-forward *relevant elimination net losses* in a Jurisdiction continues to apply unchanged. This means that any Elimination Profits (or Losses) (before deduction of *relevant elimination net losses*) of a Group from the intervening Period(s), as well as any *transferred losses*, are included in the calculation of *relevant net losses* available for deduction in any subsequent Period where the Covered Group is in scope (with reference to *elimination eligible prior periods*, defined in paragraph 13(d)). There is no difference in treatment between *relevant elimination net losses* that are incurred by a Group before or after it first falls into scope under Article 3, with the exception of the limited optionality provided in respect of the deduction of certain *transferred elimination losses*, discussed below.

1322. Subparagraph (b) defines the term “*relevant elimination net losses*”, to include (i) the “eligible elimination net losses” of the Covered Group in the Jurisdiction; and (ii) any “transferred elimination losses” available in the Jurisdiction pursuant to an “*eligible business combination*” or an “*eligible division*”, subject to certain conditions. These are discussed below in further detail.

Eligible elimination net losses

1323. Subparagraph (c) defines the term “eligible elimination net losses”. The calculation of *eligible elimination net losses* requires a retrospective computation of the *elimination profit or loss* (before deduction of any *relevant elimination net losses*) in the Jurisdiction for each *elimination eligible prior period* (defined in paragraph 13(d)), applying the same tax base rules consistently to prior periods as to the current Period. For each prior period, the starting point is therefore the sum of the *entity elimination profit (or loss)* of each Group Entity and the *taxable presence elimination profit (or loss)* of each Taxable Presence in that Jurisdiction (as defined in paragraphs 2 and 3, respectively). Adjustments are made as needed to ensure that the *eligible elimination net losses* are deducted in the chronological order of the prior period(s) to which they correspond. For each prior period, reference is made to Group Entities and Taxable Presences that are located in the Jurisdiction in that prior Period, in accordance with the rules set out in paragraph 5 (noting that *eligible elimination net losses*, forming part of the *relevant elimination net losses* in a Jurisdiction, are a Jurisdiction attribute of the Covered Group and do not attach to specific Group Entities or Taxable Presences).

1324. *Eligible elimination net losses* will exist in a Jurisdiction to the extent that, after making those computations for each *elimination eligible prior period*, the total amount of cumulative elimination losses exceeds the total amount of cumulative elimination profits (before deduction of any *relevant elimination net losses*) over the *eligible elimination prior periods* in that Jurisdiction. Pursuant to subparagraph (d), described below, the same rules apply for purposes of calculating the amount of losses of a separate business that can be transferred to the Covered Group in the Jurisdiction (“transferred elimination losses”).

Transferred losses

1325. The rules on *transferred elimination losses* provide that the Covered Group, in certain circumstances, will deduct unrelieved losses incurred in a Jurisdiction by a business that was not part of the Covered Group at that time, but that has since become so.

1326. Subparagraph (b)(ii) and (iii) set out the conditions under which a Covered Group must deduct *transferred elimination losses*, as part of its *relevant elimination net losses*, in a Jurisdiction. The general conditions of availability of *transferred elimination losses* align with those provided for the deduction of *transferred losses* in the computation of the Adjusted Profit Before Tax (Annex B Section 2(3)(b)(i) and (ii)): losses may only be transferred following an *eligible business combination* or *eligible division*, provided the business continuity requirements, applicable at the Group level, are satisfied (paragraph 6(b)(ii)).

1327. However, while the deduction of *transferred losses* in the computation of Adjusted Profit Before Tax is at the election of the Covered Group, the deduction of *transferred elimination losses* in the computation of Elimination Profit (or Loss) is mandatory, subject to limited exceptions (paragraph 6(b)(iii)). This is because the Elimination Profit (or Loss) in a Jurisdiction serves to calculate the amount of profit used for purposes of the elimination of double taxation under the Convention. Any option not to recognise such losses would increase the amount of Elimination Profit in the Jurisdiction, and thereby have a direct impact on that Jurisdiction’s relieving obligations under the Convention. In this context, optionality is targeted to limited cases where the compliance burden borne by the Covered Group would be disproportionate. By contrast, broad optionality can be provided in the context of computing a Covered Group’s Adjusted Profit Before Tax as that amount does not directly impact a Jurisdiction’s taxing right under the Convention.

Computing transferred elimination losses

1328. Subparagraph (d) defines the term “transferred elimination losses” and provides the rules to calculate the amount of *transferred elimination losses*, if any, arising from an *eligible business combination*

or an *eligible division* (i.e., the only two transactions that could give rise to *transferred losses* and/or *transferred elimination losses*, defined in Annex B Sections 2(4) and 4(6)(d), respectively). These rules broadly align with the framework provided to calculate *transferred losses* in the context of computing the Adjusted Profit Before Tax (Annex B Section 2(4)), adapted as necessary to reflect the jurisdictional context of Elimination Profit (or Loss).

1329. The quantum of *transferred elimination losses* is computed by applying the Elimination Profit (or Loss) rules (i.e. on a jurisdictional basis) consistently to the transferred Group, Entity, or *predecessor group* (subparagraph (c)). Importantly, only losses incurred within the time limitations described in the definition of eligible elimination prior period may be taken into consideration.

1330. In the case of an *eligible business combination*, *transferred elimination net losses* comprise the total amount that would have been *relevant elimination net losses* of the *transferred entity or group* in the Jurisdiction at the time of the *eligible business combination*. In the case of an *eligible division*, *transferred elimination net losses* comprise the total amount that would have been *relevant elimination net losses* of the *predecessor group* in the Jurisdiction at the time of the *eligible division*, determined with reference only to the Group Entities and Taxable Presences, if any, of the *predecessor group* that are transferred to the Covered Group as a result of the *eligible division*.

1331. In all cases, the amount of *transferred elimination losses* is determined as if the *elimination eligible prior period(s)* of the *transferred entity or group* or *predecessor group* included only prior Period(s) that would be *elimination eligible prior period(s)* of the Covered Group if any *unused elimination loss* of the *transferred entity or group* were an *unused elimination loss* of the Covered Group. In other words, in any given Period, the time limitations apply in exactly the same way for purposes of carrying forward a Covered Group's *eligible elimination net losses*, on the one hand, and any *transferred elimination losses*, on the other.

Opting out of the deduction of transferred elimination losses

1332. The deduction of *transferred elimination losses* in the computation of Elimination Profit (or Loss) is mandatory, subject to limited exceptions described in paragraph 6(b)(iii). A Covered Group may only elect to opt-out of deducting *transferred elimination losses* arising from a particular business *eligible business combination* or *eligible division* if the following three cumulative conditions are met:

- the Covered Group does not elect to deduct *transferred losses*, in computing its Adjusted Profit Before Tax, arising from the same *eligible business combination* or *eligible division* (paragraph 6(b)(iii)(A)). This requirement is intended to ensure a degree of alignment between the Adjusted Profit Before Tax and Elimination Profit (or Loss). It effectively makes the election to deduct *transferred losses* in the Adjusted Profit Before Tax contingent upon recognising *transferred elimination losses* arising from the same transfer in the Elimination Profit (or Loss). In other words, in all cases where a Covered Group elects to deduct *transferred losses* arising from a particular transfer in computing its Adjusted Profit Before Tax, it will be required to compute and deduct *transferred elimination losses* in respect of that same transfer in computing its Elimination Profit (or Loss);
- the Covered Group makes the election to opt-out of deducting *transferred elimination losses* in the first Period ending after the *eligible business combination* or *eligible division* in which the Covered Group is a Covered Group (paragraph 6(b)(iii)(B)); and

- the *eligible business combination* or *eligible division* qualifies under one of two alternative tests: the materiality threshold or the safe harbour for new Covered Groups (paragraph 6(b)(iii)(C)(a) and (b), respectively). These are described in further detail below.

1333. **Materiality threshold.** Paragraph 6(b)(iii)(C)(a) allows a Covered Group to opt-out of deducting *transferred losses* arising from a particular *eligible business combination* or *eligible division* (provided the conditions in paragraph 6(b)(iii)(A) and (B) are also met), where the transfer does not meet a certain materiality threshold. This materiality threshold comprises two cumulative components, requiring that (i) the aggregate amount of domestic loss carry-forwards of the transferred Entities fall below a threshold amount; and (ii) at least two Jurisdictions be involved in the transfer. These components are detailed below.

1334. To satisfy the first component of the materiality threshold, the aggregate amount of *tax losses* of the Group Entities of the transferred group, entity or *predecessor group* in the Jurisdiction must be lower than the threshold amount (EUR 2 million). This is calculated with reference to the Period immediately preceding the *eligible business combination* or *eligible division*. In other words, the aggregate amount of domestic tax loss carry-forwards of the Entities transferred to the Covered Group in the Jurisdiction as part of the same transfer must be lower than EUR 2 million. The amount of *tax losses* should be easily identifiable, and it provides an indication of the likely order of magnitude of any underlying losses that may be available for transfer in the context of the Elimination Profit (or Loss) calculations. If the aggregate amount of *tax losses* in the transferred Entities is very low, it would be unlikely that a significant amount of *transferred elimination losses* would be available.

1335. To satisfy the second component of the materiality threshold, the transferred group, entity or *predecessor group* must have had Group Entities and Taxable Presences located across at least two Jurisdictions. In cases where the *transferred group, entity* or *predecessor group* was located in a single Jurisdiction only, the calculations required to compute *transferred elimination losses* would be significantly simpler as compared to those involving multiple jurisdictions. As a result, where only one Jurisdiction is involved, the materiality threshold would not be satisfied and the Covered Group would have to compute and deduct *transferred elimination losses* (unless the transfer otherwise qualifies under the alternative test, i.e. the safe harbour for new Covered Groups, in paragraph 6(b)(iii)(C)(b)).

1336. **Safe harbour for new Covered Groups.** Paragraph 6(b)(iii)(C)(b) allows a Covered Group to opt-out of deducting *transferred losses* arising from a particular *eligible business combination* or *eligible division* (provided the conditions in paragraph 6(b)(iii)(A) and (B) are also met), where the transfer occurs more than two years before the Covered Group comes into scope for the first time. This is intended as a transitional measure to relieve the potential compliance burden for new Covered Groups in calculating their *relevant elimination net losses* in each Jurisdiction. This safe harbour applies as an alternative to the materiality threshold in paragraph 6(b)(iii)(C)(a); it covers all transfers occurring before the specified time, regardless of their other characteristics.

Paragraph 7

Definition of “Profit Allocation Adjustment”

1337. Paragraph 7 contains the definition of *profit allocation adjustment*. The term is relevant in determining the *entity elimination profit (or loss)* of a Group Entity (see paragraph 1222 of this Explanatory Statement above) under Annex B Section 4(2)(c). The adjustment seeks to align the Elimination Profit (or Loss) with the corporate income tax base by taking into consideration situations where a Group Entity is subject to domestic corporate income tax based on a transaction value attributed to a *covered profit allocation transaction* that does not align with the transaction value recognised in the Entity Financial Accounting Profit (or Loss) for that Group Entity.

1338. *Profit allocation adjustments* apply with respect to adjustments made for domestic corporate income tax purposes to the profits of a Group Entity in respect of *covered profit allocation transactions* entered into by that Entity. A *covered profit allocation transaction* broadly means a transaction between two or more Group Entities that results in taxable income or an allowable deduction for at least one of those Group Entities. The term “covered profit allocation transaction” is defined in paragraph 13(a) (see paragraph 1447 of this Explanatory Statement).

Subparagraph (a)

1339. Subparagraph (a) provides that the *profit allocation adjustment* of a Group Entity for a Period is the sum of two elements. First, subdivision (i) provides for inclusion of an amount equal to the *profit allocation amount* with respect to each transaction that satisfies either clause (A) or (B). For this purpose, clause (A) refers to each *covered profit allocation transaction* for which the Group Entity has included income or expenses in the computation of its Entity Financial Accounting Profit (or Loss) for the current Period (i.e., the Period in respect of which the Amount A Tax Return and Common Documentation Package is filed). Clause (B) refers to each *covered profit allocation transaction* that was not included in computation of its Entity Financial Accounting Profit (or Loss) for the Period that is subject to a *tax liability determination* with respect to the Period, i.e. for which the Group Entity has not included income or expenses for each *covered profit allocation transaction* in the computation. The *profit allocation amount* for the current Period is determined using subparagraph (b). Second, subdivision (ii) provides for the inclusion of *profit allocation spreading adjustments* which relate to *tax liability determinations* made during the current Period in respect of transactions in prior Periods. How *profit allocation spreading adjustments* should be included is determined using subparagraphs (c) and (d).

Subparagraph (b)

1340. This *profit allocation amount* for a Group Entity with respect to a *covered profit allocation transaction* in the Period that income or expenses are recognised in its Entity Financial Accounting Profit (or Loss) is calculated in accordance with subparagraph (b) and is the difference between the amount of income or expenses included during the Period for purposes of computing its Entity Financial Accounting Profit (or Loss) from each *covered profit allocation transaction* and the transaction value for tax purposes in the most recent *tax liability determination* for that *covered profit allocation transaction* in the Jurisdiction as of 60 days before the deadline for filing the Covered Group’s Amount A Tax Return and Common Documentation Package for the Period. In instances where there is no amount included in the calculation of Entity Financial Accounting Profit (or Loss) with respect to a *covered profit allocation transaction* for the Period and that *covered profit allocation transaction* is subject to a *tax liability determination* with respect to the Period, the difference that is taken into account for purposes of this subparagraph (b) is the transaction value attributed to that *covered profit allocation transaction* in the applicable *tax liability determination*.

1341. In this context *tax liability determination* is defined in paragraph 13(g). In most instances, the applicable *tax liability determination* would be the original tax return of the Group Entity. However in some instances, it is possible that an amended self-assessed tax return could be filed prior to 60 days before the deadline for filing the Covered Group’s Amount A Tax Return and Common Documentation Package for the Period and in that case that amended self-assessed tax return would be the applicable *tax liability determination* for the Period. In limited cases a tax liability assessment could be raised by a tax administration 60 days before the deadline for filing the Covered Group’s Amount A Tax Return and Common Documentation Package for the Period and in that case that tax liability assessment may be the applicable *tax liability determination* for the Period.

1342. If no *tax liability determination* in respect of the current Period has been made for the Group Entity 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period or where the *tax liability determination* and the transaction amount recognised in the Entity Financial Accounting Profit (or Loss) are the same, there will be no adjustment in that Period with respect to *covered profit allocation transactions and the profit allocation amount* will be zero.

1343. For the purpose of assessing whether a *tax liability determination* exists in relation to a Group Entity that is party to a *covered profit allocation transaction*, a determination in the location of the Group Entity that satisfies the requirements of paragraph 13(g) and relates to a Qualifying Domestic Minimum Top-Up Tax or similar tax will be considered to be a *tax liability determination* for the purpose of determining the *profit allocation amount* for that *covered profit allocation transaction* from the perspective of that Group Entity only in cases where no other corporate income tax applies in the Jurisdiction where that Group Entity is located.

Subparagraph (c)

1344. Subparagraph (c) includes in the *entity elimination profit (or loss)* changes in the *profit allocation amount* for a *covered profit allocation transaction* of the Group Entity. This would include both instances where an amount was included in Entity Financial Accounting Profit (or Loss) with respect to that transaction and cases where no transaction was recognised in the Entity Financial Accounting Profit (or Loss) in the Period that the transaction occurred. This subparagraph is limited in its application to only apply with respect to a *covered profit allocation transaction* for which income or expense originates in a prior Period in which the Group was a Covered Group.

1345. Subparagraph (c) requires that an amount will only be recognised in the Period under subparagraph (c) if at least 75 per cent of the additional tax liability or tax refund associated with the applicable *tax liability determination* is paid before the end of that Period.

1346. Where the taxpayer or tax administration has made no or insufficient payment following a *tax liability determination*, including in cases where it has lodged an appeal against the tax assessment or initiated compliance proceedings, the change in *profit allocation amount* will not (yet) be taken into account for purposes of calculating the *profit allocation amount* and accordingly determining the *entity elimination profit (or loss)*. Once at least 75% of the additional tax or refund amount is paid in aggregate, for example in a case where the taxpayer decides to accept the tax assessment or loses the appeal and is compelled to make payment, the change in *profit allocation amount* from the *tax liability determination* must be recognised in that Period. A *tax liability determination* can therefore only create a potential obligation to relieve double taxation for the purposes of Amount A where at least 75 per cent of the additional tax is paid or at least 75 per cent of the refund is paid.

Box 25. Example – Profit allocation adjustments

- For example the Amount A Tax Return and Common Documentation Package for the year ended 31 December 2029 was due on 31 December 2030. One of the Group Entities (Group Entity A) filed a corporate income tax return in Jurisdiction A on 30 September 2030 for the year ended 31 December 2029 including income with respect to a *covered profit allocation transaction* of EUR 1 000. If the same transaction amount was reflected in the Entity Financial Accounting Profit (or Loss) of Group Entity A with respect to that *covered profit allocation transaction* then the applicable *profit allocation amount* would be EUR 0 for 2029 (the current

Period). No amount would be recognised in the 2029 Amount A Tax Return and Common Documentation Package filing by virtue of paragraph 7(b).

- In 2032, the tax authority of Jurisdiction A made an upwards adjustment of EUR 3 000 to the income allocated with respect to that transaction in 2029 (so that the total income allocable to the *covered profit allocation transaction* for corporate income tax purposes in Jurisdiction A in 2029 was EUR 4 000), giving rise to an additional EUR 300 of corporate income tax in Jurisdiction A (assuming a corporate income tax rate of 10% and that no additional costs are allocated in the Group Entity A). This would result in an increase of the *profit allocation amount* from EUR 0 to EUR 3 000 in 2032 with respect to the relevant transaction in 2029. If the Covered Group did not make any payment in respect of that assessment during 2032, there would be no *profit allocation spreading adjustment* of the *covered profit allocation transaction* relating to 2029 Period that would be recognised in the 2032 Period.
- Similarly, if the Covered Group made payment of EUR 100 with respect to the EUR 300 tax liability during 2032, no *profit allocation spreading adjustment* of the *covered profit allocation transaction* for the 2029 Period would be recognised in the 2032 Amount A Tax Return and Common Documentation Package with respect to the EUR 3 000 *profit allocation amount* since the tax payment did not represent at least 75% of the additional tax assessed.
- However, if during 2032, the Covered Group paid EUR 250 in respect of the EUR 300 tax liability, the 75% threshold would be met, and the Covered Group would be required to recognise a *profit allocation spreading adjustment* of the *covered profit allocation transaction* for the 2029 Period in the amount of EUR 3 000. This would be recognised in 2032 only because the change in *profit allocation amount* is less than EUR 5 million and therefore paragraph 7(c)(i) of this Section applies.
- If in circumstances where the Covered Group made the payment of EUR 250, the taxpayer appealed the increased assessment and in 2033 the courts of Jurisdiction A determined that the income allocable to the *covered profit allocation transaction* for 2029 should have been EUR 3 000 resulting in a EUR 100 refund to the Covered Group, a change in the *profit allocation amount* of EUR 1 000 relating to the *covered profit allocation transaction* for 2029 would again be observed and a *profit allocation spreading adjustment* would be made provided that the 75% payment requirement is satisfied. In determining whether the tax authority had paid 75% of the refund in this case both the outstanding amount owed by the taxpayer in relation to the prior *tax liability determination* and any payment by the tax administration would be taken into account. In this case, EUR 50 was already outstanding so provided that at least EUR 25 is paid from the tax administration to the taxpayer before the end of 2033 that change should be recognised in the Amount A Tax Return and Common Documentation Package for 2033.

1347. As the *entity elimination profit (or loss)* is determined on an entity-by-entity basis, it is possible that Group Entities that were party to the same *covered profit allocation transaction* may reflect asymmetrical outcomes for the treatment of that transaction in their respective *entity elimination profit (or loss)*. For example, if A Co located in Jurisdiction A entered into a transaction with B Co located in Jurisdiction B pursuant to which A Co agreed to provide services to B Co in return for EUR 100, A Co would include income of EUR 100 in its *entity elimination profit (or loss)* and B Co would reflect an expense of EUR 100 in its *entity elimination profit (or loss)* in the Period. If in a later Period, Jurisdiction A considered that the arm's length price for such services was EUR 120 and issued a *tax liability determination*, A Co's *entity*

elimination profit (or loss) would be increased by EUR 20 in that subsequent Period (subject to the 75 per cent payment criteria being satisfied). However, it may not be the case that B Co's *entity elimination profit (or loss)* would be reduced by EUR 20 in that same Period, as the tax authority in Jurisdiction B may not have processed a corresponding adjustment in that Period. Spreading, described below, would not apply in this instance as the materiality threshold is not met.

1348. Where the above described conditions with respect to subparagraph (c) are satisfied (i.e., a *tax liability determination* is made in respect of a *covered profit allocation transaction* that changes the *profit allocation amount* recognised in a prior Period in respect of that *covered profit allocation transaction* or establishes a *profit allocation amount* with respect to a *covered profit allocation transaction* and at least 75 per cent of the additional tax or refund resulting from the *tax liability determination* is paid), the *tax liability determination* will be taken into account as a "profit allocation spreading adjustment" that may be subject to spreading over multiple future Periods. Applicable spreading may be determined in one of three ways depending on the circumstances of the change, as clarified in subdivisions (i) through (iii).

1349. Subdivision (i) provides that if the change in the *profit allocation amount* is less than EUR 5 million, the entire change in *profit allocation amount* shall be taken into account in the current Period as a *profit allocation spreading adjustment*. This outcome will apply regardless of whether *profit allocation spreading adjustments* relating to that *covered profit allocation transaction* are still being recognised in the current Period from a *tax liability determination* in a prior Period which might apply where a prior change in *profit allocation amount* in excess of EUR 5 million that is subject to spreading under subdivision (ii) occurred in the previous Period whereas the current change is less than EUR 5 million.

1350. Subdivision (ii) provides that if the change in the *profit allocation amount* is at least EUR 5 million, the change shall be taken into account partially in the current Period and partially in future periods.

1351. Subdivision (ii)(A) applies in cases where there has been a previous adjustment under paragraph 7(c)(ii) in the same Jurisdiction relating to the same *covered profit allocation transaction* with respect to which the *profit allocation spreading adjustment* has not been fully taken into account. In that case, that amount of the *profit allocation spreading adjustment* from the current change is combined with the remaining adjustment in respect of the prior Period that has not yet been included in determining the *entity elimination profit (or loss)* for any Period. The net amount is spread equally over Periods beginning with the current Period and consisting of the greater of:

- Three Periods;
- the number of Periods to which the determination giving rise to the current change relates; and
- the number of remaining Periods over which the *profit allocation spreading adjustment* from the prior change are spread.

1352. For example, if an upward adjustment of EUR 120 million was made by Jurisdiction A in 2028 in respect of a *covered profit allocation transaction* of A Co in respect of the 2026 tax year, the *profit allocation spreading adjustment* would be made over three Periods as the adjustment relates to a single tax year. Assuming at least 75% of the additional tax was paid in 2028, an adjustment of EUR 40 million would be made in the three Periods commencing from 2028. If, two years later in 2030, a subsequent downward adjustment of EUR 10 million was made by Jurisdiction A in respect of the same transaction and the 2026 tax year, clause (A) would apply. The net adjustment would be EUR 30 million (i.e. where the remaining amount in respect of the prior adjustment would be EUR 40 million (EUR 120 million less two years of spreading adjustments recognised in 2028 and 2029) less the new EUR 10 million downward adjustment) which would be required to be spread equally across three Periods. Three is the minimum number of

Periods over which a *profit allocation spreading adjustment* may be spread under clause (A). That is greater than the number of Periods to which the 2030 adjustment relates and the number of remaining Periods over which the remainder of the 2028 adjustment will be made (in both cases, one Period)).

1353. For purposes of applying the rules in subdivision (ii), the number of Periods to which the determination giving rise to the current change relates should be interpreted having regard to the Explanatory Statement with regard to the definition of *tax liability determination* (see paragraph 1465).

1354. Commonly the number of Periods impacted by both the current change in *profit allocation amount* and the previously recognised *profit allocation amount* that has not yet been fully recognised will be the same. This might be because the second change relates to a challenge to an original tax assessment and the scope of both determinations is the same. Where this is the case, the re-setting of the applicable spreading period will result in a prolonging of the number of Periods over which the original adjustment is recognised.

1355. If an upward adjustment of EUR 120 million was made by Jurisdiction A in 2028 in respect of a *covered profit allocation transaction* of A Co in respect of the 2021 to 2026 tax years, the *profit allocation spreading adjustment* would be made over six Periods as the adjustment relates to six tax years. Assuming at least 75% of the additional tax was paid in 2028, an adjustment of EUR 20 million would be made in each of the six Periods commencing from 2028. If, two years later in 2030, a subsequent downward adjustment of EUR 20 million was made by Jurisdiction A in respect of the same transaction and the 2021 to 2026 tax years, clause (A) would apply. The net adjustment would be EUR 60 million (i.e. where the remaining amount in respect of the prior adjustment would be EUR 20 million (EUR 120 million less two years of spreading adjustments recognised in 2028 and 2029) less the new EUR 20 million downward adjustment) which would be required to be spread equally across six Periods. Six is the number of Periods to which the determination giving rise to the 2030 change relates (2021-2026). That is greater than the default three Periods and the number of Periods remaining for the 2028 adjustment (four Periods, assuming the refund is paid in 2030)).

1356. Subdivision (ii)(B) applies in all other cases that are not covered by clause (A) where the change in the *profit allocation amount* is at least EUR 5 million. That would be the case if, for example, there has been no previous *profit allocation adjustment* in respect of the same *covered profit allocation transaction*, or there has been such an adjustment, but the full amount of that prior adjustment has already been taken into account. In those cases, the adjustment is spread equally across a term beginning with the current Period and consisting of the greater of three Periods; and the number of Periods to which the determination giving rise to a change in the *profit allocation amount* relates.

1357. For example, if an upward adjustment of EUR 120 million was made by Jurisdiction A in 2030 in respect of the profits arising in 2028 from a *covered profit allocation transaction* entered into by A Co with another Group Entity, B Co in Jurisdiction B, that adjustment should be treated as a *profit allocation adjustment* under paragraph 7(a)(ii). Assuming that the EUR 120 million adjustment was the first adjustment made by Jurisdiction A in respect of that transaction, clause (A) would require that the upward adjustment of EUR 120 million be included in the *entity elimination profit (or loss)* of A Co. The inclusion would be required to be spread equally across three Periods because the adjustment relates to a single Period (2028). Accordingly, an adjustment of EUR 40 million would be included in the *entity elimination profit (or loss)* of A Co for each Period commencing in 2030, assuming at least 75% of the tax would be paid in that year. If Jurisdiction A made a subsequent downward adjustment to the profits of the same *covered profit allocation transaction* in 2034 (by which time the 2030 adjustment would have been fully included), subdivision (ii)(B) would again apply to spread the new adjustment in isolation over three Periods (as the 2030 adjustment would be fully recognised at that time).

1358. Subdivision (iii) provides that if a Group Entity that is subject to the *profit allocation spreading adjustments* under paragraph 7(c)(ii) leaves the Covered Group in a Period and the full amount of the *profit allocation spreading adjustment* has not yet been taken into account, the remaining amount of the adjustment that has not been spread across prior Periods must be included in the *entity elimination profit (or loss)* in the Period that the Group Entity leaves the Covered Group. If the Group Entity that is subject to a *profit allocation spreading adjustment* ceases to exist, then the requirement provided in subdivision (iii) will be deemed to be satisfied.

1359. For example, if an upward adjustment of EUR 9 million was made by Jurisdiction A in 2028 in respect of a *covered profit allocation transaction* of A Co in respect of the 2027 tax year and the adjustment was spread over three Periods, an adjustment of EUR 3 million would be made each Period commencing in 2028 (assuming that at least 75% of the additional tax was paid in 2028). If, one year later in 2029, the Group Entity in respect of which the *profit allocation adjustment* was made leaves the Covered Group, the remaining amount of the adjustment that has not been spread across prior Periods would be EUR 6 million (being EUR 9 million less EUR 3 million applied in 2028). Under subdivision (iii), that EUR 6 million must be included in the *entity elimination profit (or loss)* of the Group Entity for 2029.

Subparagraph (d)

1360. Subparagraph (d) is designed to deal with cases where a Covered Group comes in and out of scope of Amount A. It is intended to ensure that *tax liability determinations* with respect to *covered profit allocation transactions* that relate to income or expenses recognised in the Entity Financial Accounting Profit (or Loss) of the Group Entity in Periods when the Group was in scope of Amount A that are made during Periods when the Group is not in-scope of Amount A are taken into account when the Group subsequently comes back into scope of Amount A. The provision will not apply if the most recent change in *profit allocation amount* occurred more than two Periods before the Group comes back into scope.

1361. With respect to a *profit allocation transaction* in a prior Period, a change in the *profit allocation amount* will be recognised in respect of that *profit allocation transaction* in the Period where conditions in subparagraph (i) and (ii) are satisfied.

1362. The first condition is that the Group was not a Covered Group in the immediately preceding Period. The second condition is that the most recent change in *profit allocation amount* prior to the Period with respect to a *covered profit allocation transaction* resulted from a *tax liability determination* during a Period when the Group was not a Covered Group and less than two years before the beginning of the Period. In those cases, the *profit allocation amount* in the Period will be deemed equal to the relevant *profit allocation amount* in the latest *tax liability determination* prior to the end of the current Period, less the *relevant profit allocation amount* recognised in the latest *tax liability determination* with respect to that *covered profit allocation transaction* during a prior Period where the Group was a Covered Group.

1363. For example, a Group that was in-scope of Amount A in 2028 recognised a *covered profit allocation transaction* generating income in Jurisdiction A of EUR 100 million in 2028. The Group fell out of scope of Amount A in 2029. In 2030, the tax authority in Jurisdiction A made an upward adjustment of EUR 30 million with respect to the *covered profit allocation transaction* in Jurisdiction A for 2028. If the Group came back into scope of Amount A in 2031 (less than two Periods after the change in *profit allocation amount* took place) the Covered Group would recognise an increase in the *profit allocation amount* in Jurisdiction A of EUR 30 million (assuming that at least 75% of the additional tax was paid). This adjustment would be subject to spreading treatment as described above commencing from 2031.

1364. In addition, there could be situations where both subparagraphs (c) and (d) apply to a Group Entity with respect to a *covered profit allocation transaction* in a given Period. In such a case, the net of the

amounts determined under those two subparagraphs would be considered to be the relevant *profit allocation amount*. Paragraph 1573 of the Explanatory Statement provides a description of how these provisions would apply in the context of a *withholding tax upward adjustment* and the same concepts apply in this context.

Paragraph 8

Definition of “Qualifying Reorganisation Adjustment”

1365. Special rules related to specified corporate restructurings are intended to produce outcomes that are generally aligned with the local tax treatment of such transactions. Paragraph 2(e) provides that *qualifying reorganisation adjustments* will be made in determining the *entity elimination profit (or loss)* of a Group Entity. The definition of *qualifying reorganisation adjustment* is included in paragraph 8. This paragraph provides rules for the recognition or non-recognition of a gain or loss on the disposition of assets or liabilities and for determining the carrying values of assets and liabilities acquired or disposed in connection with a *qualifying reorganisation*.

1366. The term “qualifying reorganisation” is defined in paragraph 13(f). It is a broad definition that refers to an arrangement where a Group Entity transfers assets and liabilities to another entity and receives consideration in whole or in significant part comprised of equity interests that carry rights to the profits, capital or reserves of an Entity that are issued by the acquiring Group Entity or by a person connected with the acquiring Group Entity, or, in the case of a liquidation, equity interests that carry rights to the profits, capital or reserves of the target (or, when no consideration is provided, where the issuance of an equity interest would have no economic significance).

1367. The definition may apply to mergers, demergers, liquidations, or similar transactions, and can apply to domestic as well as cross-border transactions. The provisions of paragraph 13(f) do not require that a disposing Group Entity and an acquiring Group Entity belong to the same Covered Group and apply irrespective of whether the counterparty to the transaction itself is a Group Entity that is part of a Covered Group subject to the Convention. A transfer of assets and liabilities qualifies as a *qualifying reorganisation* if the conditions in paragraph 13(f)(i) through (iii) are met.

1368. Paragraph 13(f)(i) determines that the consideration for the transfer of assets and liabilities must be, in whole or in significant part, equity interests that are issued by the acquiring Group Entity or by a person connected with the acquiring Group Entity. A person should be treated as connected with the acquiring Group Entity for this purpose if it meets the conditions set out in Article 5(8) of the OECD Model or in Article 5(9) of the UN Model. In the case of a liquidation, however, the consideration can be in the cancellation of equity interests in the target. No consideration is necessary where the issuance of an equity interest would have no economic significance, for instance because the transaction does not result in a change in the relative ownership of the Group Entity. The definition of *qualifying reorganisation* does not impose any requirement with respect to whom the equity interests are issued. For instance, a transaction in which the equity interests are issued to the direct or indirect owner of the Entity whose assets and liabilities are acquired as part of the same arrangement could qualify as a *qualifying reorganisation*.

1369. The criteria included in paragraph 13(f)(ii) and (iii) relate to the tax treatment of the transaction under local law. Under subdivision (ii), the disposing Group Entity’s gain or loss on the assets and liabilities must be partially or wholly non-taxable at the time of the transaction. A reorganisation may, for instance, be partly non-taxable where there is a limit to the amount of non-equity consideration that can be paid as part of the consideration for the transaction to qualify as a reorganisation under the local tax rules. Amounts paid over that limit may constitute a taxable consideration that triggers the recognition of a gain or loss in respect of the assets transferred pursuant to the reorganisation.

1370. Subdivision (iii) stipulates that the tax laws of the Jurisdiction in which the acquiring Group Entity is located must require the acquiring Group Entity to compute taxable income after the acquisition using the carrying value of the assets for tax purposes, adjusted for any partial taxation of the disposition or acquisition. The local tax rules should thus ensure that the gain or loss on the acquired assets and liabilities does not permanently escape taxation but is only deferred. To the extent that a gain or loss is recognised, the tax base is adjusted to ensure that such gain or loss is not subject to tax again in the future.

1371. Paragraph 8(a) provides that where a reorganisation constitutes a *qualifying reorganisation*, the disposing Group Entity will not recognise the gain or loss from the transfer of the assets and liabilities for purposes of calculating its *entity elimination profit (or loss)*. This provision addresses instances where a reorganisation is both wholly and partially exempt from tax from the perspective of the disposing Group Entity. Where a *qualifying reorganisation* is partially exempt from tax, the disposing Group Entity will include in its *entity elimination profit (or loss)* the lesser of the gain or loss arising in connection with the *qualifying reorganisation* that is subject to tax and the gain or loss included in Entity Financial Accounting Profit (or Loss) in connection with the reorganisation.

1372. Pursuant to paragraph 8(b), the future *entity elimination profit (or loss)* of the acquiring Group Entity will be determined on the basis of the historical carrying amounts of the acquired assets and liabilities. The Group Entity must maintain accounting records to support the computation of *entity elimination profit (or loss)* by reference to the historical carrying amounts of the acquired assets and liabilities.

1373. Where the acquiring Group Entity increases or decreases the carrying amounts of the acquired assets and liabilities to account for the gain or loss of the disposing entity that is included in *entity elimination profit (or loss)*, the changes in the carrying values for *entity elimination profit (or loss)* purposes must be allocated among the assets and liabilities in a manner consistent with the increases and decreases of those assets under the tax law applicable to the acquiring Group Entity. For example, if the Group Entity is required by local tax rules to allocate the basis increases due to the tax gain to depreciable assets up to the amount of the built-in gain on such assets first, and then to inventory and other current assets, the Group Entity must do the same for *entity elimination profit (or loss)* purposes. However, the increase or decrease in carrying value of assets and liabilities for *entity elimination profit (or loss)* purposes cannot exceed the gain or loss that was included in *entity elimination profit (or loss)* under paragraph 8(a).

Paragraph 9

Definition of “taxable equity transaction adjustment”

1374. Paragraph 2(g) provides that *taxable equity transaction adjustments* will be made in determining the *entity elimination profit (or loss)* of a Group Entity. The definition of *taxable equity transaction adjustment* is included in paragraph 9.

1375. Paragraph 9 covers an acquisition (or disposition) of an equity interest in a Group Entity (the target) where the Jurisdiction of the target treats the transaction as an acquisition and disposition of the underlying assets and liabilities for tax purposes and imposes a *covered tax* on the gain or loss from the deemed disposition of assets and liabilities by the seller. This provision includes situations where the target Jurisdiction imposes a *covered tax* on the seller based on the difference between the tax basis of the assets and the tax amounts of the liabilities and the consideration paid or fair value.

1376. The covered tax must be imposed by the Jurisdiction in which the target Group Entity is located, as determined under paragraph 5. Where the target Group Entity qualifies as a *tax transparent entity*, as defined in paragraph 4(c), paragraph 9 applies where the covered tax is imposed by the Jurisdiction in which the assets in respect of which the gains are deemed are located.

1377. There are two conditions for paragraph 9 to apply. The first is that the Jurisdiction of the target Group Entity treats the transaction as, or similar to, an acquisition or a disposal of the underlying assets and liabilities for tax purposes. This condition includes situations where, on acquisition of an equity interest in the target, for tax purposes, the Jurisdiction of the target Group Entity treats the assets and liabilities of that Group Entity as though they had been transferred to another Group Entity located in that Jurisdiction.

1378. The second condition is that the Jurisdiction of the target Group Entity imposes a covered tax on the seller based on the difference between the tax basis of the underlying assets and amount of the underlying liabilities and the consideration received in exchange for the equity interest, or the difference between that tax basis and fair value of the assets and liabilities. The second condition is met in situations where the target Jurisdiction imposes a covered tax on the seller based on the difference between the consideration received by the seller and the tax basis of the target's underlying assets and liabilities. The second condition can also be met where the target Jurisdiction imposes a covered tax on the seller based on the difference between the fair value of the underlying assets and liabilities and the target's tax basis.

1379. Where the conditions of paragraph 9 are fulfilled and the seller is located in the Jurisdiction that imposed the tax, the seller of the equity interest must adjust its *entity elimination profit (or loss)* to include the gains on which it is liable to tax. In other instances a Taxable Presence will be located in the Jurisdiction imposing the tax and the gains will be recognised in the *taxable presence elimination profit (or loss)* of that Taxable Presence.

Paragraph 10

Definition of "tax fair value adjustments"

1380. Paragraph 2(h) provides that *tax fair value adjustments* will be made in determining the *entity elimination profit (or loss)* of a Group Entity. The definition of *tax fair value adjustment* is in paragraph 10.

1381. A Group Entity may be required or permitted to adjust the tax basis of its assets or the tax amount of its liabilities under domestic law for a variety of reasons. Perhaps the most common circumstance is where a Group Entity is subject to an exit tax because of a cross-border reorganisation or a change in the Entity's tax residence. In addition, a Group Entity may be required to adjust the tax basis or amount of some or all of its assets and liabilities when it joins or leaves a tax consolidated group. In other cases, the Group Entity (or its owners) may be permitted to make an election that adjusts the tax basis of assets and tax amount of liabilities. The adjustments required by these local tax rules are usually, but not always, based on the fair value of the asset or liability.

1382. Paragraph 2(h) in conjunction with paragraph 10 provides that a Covered Group must in these situations align its *entity elimination profit (or loss)* with the outcomes under the local tax law. These provisions do not apply to ordinary sales of assets (e.g. sales of inventory) by a Group Entity or to *profit allocation adjustments*. Moreover, if this adjustment is made in connection with the acquisition of an equity interest to which paragraph 9 applies, the adjustment does not affect the application of paragraph 9 to the seller.

1383. Under subparagraph (a), the gain or loss with respect to each asset or liability to be included in the *entity elimination profit (or loss)* is initially determined based on the difference between the carrying value for financial accounting purposes of the asset or liability immediately before the date of the event that triggered the tax adjustment (the triggering event), and the fair value of the asset or liability immediately after the triggering event. The carrying value of the asset or liability prior to the triggering event can be calculated by subtracting any depreciation or other valuation adjustment leading up to the trigger event from the carrying value of the asset or liability at the beginning of the Period. Where the triggering event is

the acquisition of an equity interest in a Group Entity, the fair value of all the assets and liabilities of the Group Entity will typically be commensurate with the acquisition cost of the equity interest. Because the triggering event may occur as a result of, or in connection with, a *qualifying reorganisation*, the amount of the gain (or loss) must then be reduced (or increased) by the amount of gain (or loss) already recognised in the *qualifying reorganisation adjustment*. Subparagraph (a) thus prevents duplication of gains and losses that have already been included in the *entity elimination profit (or loss)* under paragraph 2(e) in conjunction with paragraph 8.

1384. Pursuant to subparagraph (b), the Group Entity will use the fair value of the assets and liabilities to compute its *entity elimination profit (or loss)* in the Periods ending after the triggering event. The fair value to be used is the fair value of the assets determined pursuant to the financial accounting standard used in the Consolidated Financial Statements.

1385. Subparagraph (c) contains rules providing how the net gain or loss on the sum of asset and liability revaluations under subparagraph (a) is to be included in the Group Entity's *entity elimination profit (or loss)*. If the net total gain or loss equals or exceeds EUR 5 million, paragraph 10(c)(i) provides that the net gain or loss is spread pro rata over five consecutive Periods starting with the Period in which the triggering event occurs. If the Group Entity leaves the Covered Group before the end of the five-year period, the remainder of the gain or loss must be accelerated and taken into account in the Period in which the Group Entity leaves the Covered Group. If the net total gain or loss is less than EUR 5 million, paragraph 10(c)(ii) provides that the total amount is included in the Group Entity's *entity elimination profit (or loss)* in the Period in which the triggering event occurs.

Paragraph 11

Definition of "main entity taxable presence adjustment"

1386. Paragraph 2(i) provides that *main entity taxable presence adjustments* must be made in determining the *entity elimination profit (or loss)* of a Group Entity (see paragraph 1243 of this Explanatory Statement above). The definition of *main entity taxable presence adjustment* is included in paragraph 11. The adjustment seeks to align the Elimination Profit (or Loss) with the corporate income tax base by taking into consideration situations where a Group Entity is subject to double tax relief with respect to tax levied on a Taxable Presence of that Group Entity in another Jurisdiction.

1387. In taking into account *main entity taxable presence adjustments*, it is intended that the *entity elimination profit (or loss)* of each Group Entity with a *taxable presence* will align with applicable domestic tax treatment of that *taxable presence* in the *main entity* Jurisdiction to the extent possible. The *main entity taxable presence adjustment* is excluded from the *entity elimination profit (or loss)* and, as such, it usually reduces the *entity elimination profit (or loss)*. The term Taxable Presence is defined in Article 2 and means a case in which a Group Entity, other than a *regulated financial institution* or an *extractives entity*, is liable to tax on a net basis, whether under an income tax or another similar type of tax, in a Jurisdiction other than the Jurisdiction in which the Group Entity is located for the Period (see paragraph 132 of the Explanatory Statement). It therefore will not include a permanent establishment in a foreign Jurisdiction that is recognised in a *main entity* Jurisdiction but that is not taxed in the location of the *taxable presence*.

1388. For example, if X Co located in Jurisdiction A had a permanent establishment in Jurisdiction B but Jurisdiction B did not tax the profits of the permanent establishment, that permanent establishment would not qualify as a Taxable Presence. Even if Jurisdiction A provided an exclusion under domestic law for profits attributable to the permanent establishment, no *main entity taxable presence adjustment* would apply in respect of the permanent establishment in Jurisdiction B as it does not qualify as a *taxable presence* for purposes of Amount A.

Subparagraph (a)

1389. Subparagraph (a) provides that the *main entity taxable adjustment* of a *main entity* with respect to its *taxable presences* for a Period is the sum of two elements. First, subdivision (i) provides for inclusion of an amount equal to the *excluded profit amount* of the *main entity* with respect to each *taxable presence* for the current Period (i.e., the Period in respect of which the Amount A Tax Return and Common Documentation Package is filed). The *excluded profit amount* for the current Period is determined using subparagraph (b). Second, subdivision (ii) requires the inclusion of *excluded profit spreading adjustments* which relate to *tax liability determinations* made during the Period in respect of prior Periods. How *excluded profit spreading adjustments* should be included is determined using subparagraphs (c) and (d).

Subparagraph (b)

1390. The *excluded profit amount* is calculated in accordance with subparagraph (b). It means the amount of profit of the *main entity* determined to be attributable to each *taxable presence* with respect to any fiscal period of that *main entity* that ends during the Period. The amount of profit is determined by reference to the amount in respect of which the *main entity* benefits from relief for double taxation. The adjustment is available regardless of how double taxation relief is given (e.g., whether under the exemption or credit method) but it is the measure of profit of the *main entity* attributable to the *taxable presence* and for which relief from double taxation is given in the Jurisdiction of the *main entity* that determines the adjustment. The *excluded profit amount* should be based on the most recent *tax liability determination* for that *main entity* in the Jurisdiction of the *main entity*. The most recent *tax liability determination* is based on what is filed or issued 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period.

1391. As the *main entity taxable presence adjustment* is determined by reference to the tax treatment in the Jurisdiction of the *main entity* independently of the determination of the *taxable presence elimination profit (or loss)* in the location of the *taxable presence*, it is possible that different profit amounts may be taken into account in respect of the same *taxable presence* in the Jurisdiction of the *main entity* and in the location of the *taxable presence*. This is similar to the approach to *profit allocation adjustments* covered under paragraph 7. The Elimination Profit (or Loss) of the Jurisdiction of the *taxable presence* would be increased by the amount of profit subject to tax in the Jurisdiction of the location of the *taxable presence* and under the laws of that Jurisdiction, and the Elimination Profit (or Loss) of the Jurisdiction of the *main entity* would be reduced by the amount of profits attributable to the *taxable presence* under the laws of the *main entity* Jurisdiction.

1392. For example, XCo located in Jurisdiction A had a *taxable presence* located in Jurisdiction B in 2026. Under the laws of Jurisdiction B, the *taxable presence* is entitled to deduct the cost of equipment acquired by the *taxable presence* in the year of acquisition. In the fiscal year 2026, the *taxable presence* acquires equipment for EUR 100. In that year, the *taxable presence* is allocated a profit of EUR 250 in Jurisdiction B. Under the laws of Jurisdiction A the cost of acquiring equipment must be depreciated over a five year period. As such in the fiscal year 2026, the profit allocated to the *taxable presence* in Jurisdiction A is EUR 330 (EUR 250 recognised in Jurisdiction B plus EUR 80 temporary difference). XCo would make a *main entity taxable presence adjustment* in Jurisdiction A and reduce its *entity elimination profit (or loss)* by EUR 330. In addition, the *taxable presence elimination profit (or loss)* in Jurisdiction B would include EUR 250 in the same Period.

1393. If the Taxable Presence of a *main entity* generates a loss, that loss will be excluded from the *excluded tax amount* to the extent that the loss is not taken into account in determining the corporate tax base of the *main entity*. This means that if the location of the *main entity* does not take account the loss to reduce the tax base in the *main entity* for corporate income tax purposes (which might occur in cases

where the *main entity* location applies a branch exemption), that loss is not taken into account in the location of the *main entity* for purposes of its Elimination Profit (or Loss).

1394. The term *tax liability determination* is defined in paragraph 13(g). In most instances, the applicable *tax liability determination* would be the original tax return of the *main entity*. However, in some instances, it is possible that an amended self-assessed tax return could be filed prior to 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period and in that case that amended self-assessed tax return would be the applicable *tax liability determination* for the Period. In limited cases, a tax liability assessment could be raised by a tax administration prior to 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period and, in that case, that tax liability assessment may be the applicable *tax liability determination* for the Period.

1395. If no *tax liability determination* in respect of the current Period has been made for the *main entity* 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period, then there will be no *main entity taxable presence adjustment* in that Period with respect to that Period.

1396. For purposes of assessing whether a *tax liability determination* exists in relation to a *main entity*, a determination in the location of the *main entity* that satisfies the requirements of paragraph 13(g) and relates to a Qualifying Domestic Minimum Top-Up Tax or similar tax will be considered to be a *tax liability determination* for purposes of determining the *excluded profit amount* only in cases where no other corporate income tax applies in the Jurisdiction where that *main entity* is located.

Subparagraph (c)

1397. Subparagraph (c) includes in the *main entity taxable presence adjustment* changes in the *excluded profit amount* of the *main entity* attributable to the Taxable Presence during the Period that relate to profits or losses originally recognised in a prior Period. This subparagraph is limited in its application to only apply with respect to changes in a *tax liability determination* of a *main entity* with respect to a Taxable Presence that existed in a prior Period in which the Group was a Covered Group.

1398. Subparagraph (c) provides that an amount will only be recognised in the Period if at least 75% of the additional tax liability or tax refund associated with the applicable *tax liability determination* is paid before the end of that Period.

1399. Where the taxpayer or tax administration has made no or insufficient payment following a *tax liability determination* in respect of a prior Period, including in cases where it has lodged an appeal against the tax assessment or initiated compliance proceedings, the change in *excluded profit amount* will not (yet) be taken into account for the purpose of determining the *taxable presence elimination profit (or loss)*. Once at least 75 per cent of the additional tax or refund amount is paid in aggregate, for example in a case where the taxpayer decides to accept the tax assessment or loses the appeal and is compelled to make payment, the change in *excluded profit amount* from the *tax liability determination* must be recognised in that Period. A *tax liability determination* can therefore only create a potential obligation to relieve double taxation for purposes of Amount A where at least 75 per cent of the additional tax is paid or at least 75 per cent of the refund is paid.

Box 26. Example – Main entity taxable presence adjustment

- For example, the Amount A Tax Return and Common Documentation Package of a Covered Group for the year ended 31 December 2029 was due on 31 December 2030. One of the Group Entities (Group Entity A) filed a corporate income tax return in its location, Jurisdiction A, on 30 September 2030 for the year ended 31 December 2029 in which it claimed relief from double tax in respect of profits subject to tax in its Taxable Presence in Jurisdiction B. In its tax return, Group Entity A attributed a profit of EUR 1 000 to that Taxable Presence. In those circumstances the *excluded profit amount* of EUR 1 000 for the Taxable Presence would be included in calculating the *main entity taxable presence adjustment* of the Group Entity in the 2029 Amount A Tax Return and Common Documentation Package filing by virtue of paragraph 11(b).
- In 2032, the tax authority of Jurisdiction A made a downwards adjustment of EUR 400 to the profit attributable to the Taxable Presence relating to 2029 (so that the total profit attributable to the Taxable Presence in Jurisdiction A in 2029 was EUR 600), giving rise to an additional EUR 40 of corporate income tax in Jurisdiction A (assuming a 10% corporate income tax rate). This would result in a reduction of the *excluded profit amount* from EUR 1 000 to EUR 600 in 2032 with respect to profits derived in the 2029 Period. If the Covered Group did not make any payment during 2032, there would be no *excluded profit spreading adjustment* of the *main entity* attributable to the Taxable Presence relating to 2029 Period that would be recognised in the 2032 Period.
- Similarly, if the Covered Group made payment of EUR 10 in respect of the EUR 40 tax liability increase during 2032, no *excluded profit spreading adjustment* of the *main entity* attributable to the Taxable Presence for the 2029 Period would be recognised in the 2032 Amount A Tax Return and Common Documentation Package since the payment made did not represent at least 75% of the additional tax assessed.
- However, if during 2032, the Covered Group paid EUR 40 in respect of the EUR 40 tax liability adjustment, the 75% threshold would be met and the Covered Group would be required to recognise an *excluded profit spreading adjustment* of the *main entity* attributable to the Taxable Presence for the 2029 Period in the amount of EUR 400.
- If in circumstances where the Covered Group made the payment of EUR 40 in 2032, the Covered Group also appealed the increased assessment and in 2033 the courts of Jurisdiction A determined that the total profit of the *main entity* attributable to the Taxable Presence for 2029 should have been EUR 800, a change in the *excluded profit amount* of the *main entity* (i.e., EUR 200, based on the difference between the prior EUR 600 *excluded profit amount* and the new EUR 800 *excluded profit amount*) attributable to the Taxable Presence for 2029 would again be observed and an *excluded profit spreading adjustment* would be observed provided that the 75 per cent requirement is satisfied. If the tax authority of Jurisdiction A paid at least 75 per cent of the refund before the end of 2033, that change should be recognised in the Amount A Tax Return and Common Documentation Package for 2033 as an *excluded profit spreading adjustment*.

1400. In practice, it may often be the case that a downward adjustment to the profits of a *main entity* in respect of a Taxable Presence is made in respect of more than one fiscal year, e.g., the tax authority of the Jurisdiction of the *main entity* may consider that the profits of the Taxable Presence were overstated for three years and adjust accordingly. In those cases, the combined adjustment is treated in aggregate

provided that all periods covered by the *tax liability determination* related to periods where the Group was a Covered Group.

1401. Where the above described conditions with respect to subparagraph (c) are satisfied (i.e., a *tax liability determination* is made in respect of a *main entity* that changes the *excluded profit amount* recognised in a prior Period in respect of the profits attributable to a Taxable Presence or that *main entity* or establishes an *excluded profit amount with respect to a main entity in a prior Period not previously recognised* and at least 75 per cent of the additional tax or refund resulting from the *tax liability determination* is paid), the *tax liability determination* will be taken into account as an "excluded profit spreading" adjustment" that may be subject to spreading over multiple future Periods. Applicable spreading is determined in one of three ways depending on the circumstances of the change, as clarified in subdivisions (i) through (iii).

1402. Subdivision (i) provides that if the change in the *excluded profit amount* is less than EUR 5 million, the entire change shall be taken into account in the current Period. This outcome will apply regardless of whether *excluded profit spreading adjustments* relating to that Taxable Presence of the *main entity* are still being recognised in the current Period from a *tax liability determination* in a prior Period which might apply where a prior change in *excluded profit amount* in excess of EUR 5 million that is subject to spreading under subdivision (ii) occurred in the previous Period whereas the current change is less than EUR 5 million.

1403. Subdivision (ii) provides that if the change in the *excluded profit amount* is greater than EUR 5 million, the change shall be taken into account partially in the current Period and partially in future Periods.

1404. Clause (A) of subdivision (ii) applies in cases where there has been a previous adjustment under subdivision (ii) in the Jurisdiction in respect of the same Taxable Presence of the same *main entity* and where all of that *excluded profit spreading adjustment* has not yet been taken into account. In that case, that new change in the *excluded profit amount* is combined with the remaining adjustment in respect of the prior Period that has not yet been included in determining the *main entity taxable presence adjustment* for any Period. The net amount is spread equally over a number of Periods beginning with the current Period and consisting of the greater of:

- three Periods;
- the number of Periods to which the determination giving rise to the current change relates;
- the number of Periods over which the remaining *excluded profit spreading adjustment* from the prior change are spread.

1405. For example, if an upward adjustment under subparagraph (b) of EUR 45 million was made by Jurisdiction A in 2028 to the profits of a *main entity* attributable to a Taxable Presence with respect to the tax years 2022 to 2026, the *excluded profit spreading adjustment* would be made over five Periods, commencing in 2028 (assuming that at least 75% of the additional tax was paid in 2028). If, three years later in 2031, following a mutual agreement procedure, a subsequent downward adjustment of EUR 5 million was made by Jurisdiction A in respect of the profits of the same *main entity* attributable to the same Taxable Presence for the tax years 2022 to 2026, the net amount under subparagraph (b) would be EUR 13 million (i.e. EUR 45 million less three years of spreading adjustments of EUR 9 million each recognised in 2028, 2029 and 2030, less the new EUR 5 million adjustment). This would be spread equally across five Periods. Five is the number of Periods to which the determination giving rise to the 2031 change relates (2022-2026). That is greater than the default three Periods and the number of Periods remaining for the 2028 adjustment (two Periods, assuming the refund is paid in 2031).

1406. For purposes of applying the rules in subdivision (ii), the number of Periods to which the determination giving rise to the current change relates should be interpreted having regard to the Explanatory Statement with regard to the definition of *tax liability determination* (see paragraph 1465).

1407. Commonly the number of Periods impacted by both the current change in *excluded profit amount* and the previously recognised *excluded profit amount* that has not yet been fully recognised will be the same. This might be because the second change relates to a challenge to an original tax assessment and the scope of both determinations is the same. Where this is the case, the re-setting of the applicable spreading period will result in a prolonging of the number of Periods over which the original adjustment is recognised.

1408. Clause (B) of subdivision (ii) applies in all other cases that are not covered by clause A where the change in the *excluded profit amount* is greater than EUR 5 million. That would be the case if, for example, there has been no previous *main entity taxable presence adjustment* in respect of the same Taxable Presence of the same *main entity* or there has been such an adjustment but the full amount of that prior adjustment has already been taken into account. In those cases, the adjustment is spread equally across a term beginning with the current Period and consisting of the greater of three Periods; and the number of Periods to which the determination giving rise to a change in the *excluded profit amount* relates.

1409. For example, if Jurisdiction A made an upward adjustment exceeding EUR 5 million to the profits of a *main entity* in respect of a Taxable Presence in 2030 related to the 2028 tax year and no previous adjustment had been made by Jurisdiction A with respect to the profits of that Taxable Presence of that *main entity*, Clause B of subdivision (ii) would operate to spread the impact of that adjustment over three Periods (assuming that at least 75% of the additional tax was paid in 2028). If Jurisdiction A made a subsequent downward adjustment to the profits of the same Taxable Presence of the same *main entity* in 2034 (by which time the 2030 adjustment would have been fully taken into account), Clause B of subdivision (ii) would again apply to spread the new adjustment in isolation over three Periods (assuming that at least 75% of the additional tax was paid in 2028) as the 2030 adjustment would be fully recognised at that time.

1410. Subdivision (iii) provides that if the *main entity* in respect of which an adjustment under subparagraph (ii) has been made leaves the Covered Group in a Period and the full amount of a *excluded profit spreading adjustment* has not yet been taken into account, the remaining amount of the adjustment that has not been spread across prior Periods must be included in the *main entity taxable presence adjustment* in the Period that the *main entity* leaves the Covered Group. If the *main entity* that is subject to an *excluded profit spreading adjustment* ceases to exist, then the requirement provided in subdivision (iii) will be deemed to be satisfied.

1411. For example, if an upward adjustment under subparagraph (b) of EUR 50 million was made by Jurisdiction A in 2028 to the profits of a *main entity* in respect of a Taxable Presence related to the 2022 to 2026 Periods and that adjustment was spread over five Periods, an adjustment of EUR 10 million would be made each year commencing in 2028 (assuming that at least 75% of the additional tax was paid in 2028). If, two years later in 2030 the *main entity* with the Taxable Presence leaves the Covered Group, the remaining amount of the adjustment that has not been spread across prior Periods would be EUR 30 million (being EUR 50 million less EUR 10 million applied in 2028 and less EUR 10 million applied in 2029). Under subdivision (iii), that EUR 30 million must be included in the *main entity taxable presence adjustment* for 2030.

Subparagraph (d)

1412. Subparagraph (d) is designed to deal with cases where a Covered Group comes in and out of scope of Amount A. It is intended to ensure that *tax liability determinations* with respect to a *main entity* regarding its Taxable Presence that relate to income or expenses recognised in the Entity Financial Accounting Profit (or Loss) of the Group Entity in Periods when the Group was in scope of Amount A that are made during Periods when the Group is not in-scope of Amount A are taken into account when the Group subsequently comes back into scope of Amount A. The provision will not apply if the most recent change in *excluded profit amount* occurred more than two Periods before the Group comes back into scope.

1413. With respect to a Taxable Presence recognised in a *main entity* in a prior Period, a change in the *excluded profit amount* will be recognised in respect of that Taxable Presence in the Period where conditions in subdivisions (i) and (ii) are satisfied.

1414. The first condition is that the Group was not a Covered Group in the immediately preceding Period. The second condition is that the most recent change in *excluded profit amount* prior to the Period with respect to that Taxable Presence recognised in that *main entity* resulting from a *tax liability determination* during a Period when the Group was not a Covered Group and less than two years before the beginning of the Period. In those cases, the *excluded profit amount* in the Period will be deemed equal to the profit (or loss) amount for that Taxable Presence subject to double taxation relief in the *main entity* in the latest *tax liability determination* prior to the end of the current Period, less the profit (or loss) amount recognised for that Taxable Presence subject to double taxation relief in the *main entity* in the latest *tax liability determination* with respect to that Taxable Presence during a prior Period where the Group was a Covered Group.

1415. For example, a Group that was in-scope of Amount A in 2028 recognised a *main entity taxable presence adjustment* in Jurisdiction A of EUR 100 million in 2028. The Group fell out of scope of Amount A in 2029. In 2030, the tax authority in Jurisdiction A made an upward adjustment of EUR 30 million with respect to profits of the Taxable Presence in Jurisdiction A for 2028. If the Group came back into scope of Amount A in 2031 (less than two Periods after the change in *profit allocation amount* took place) the *main entity* would recognise a change in the *excluded profit amount* of EUR 30 million (assuming that at least 75% of the additional tax was paid). This adjustment would be subject to spreading treatment as described above commencing from 2031.

1416. In addition, there could be situations where both subparagraphs (c) and (d) apply to a *main entity* with respect to a Taxable Presence in a given Period. In such a case, the net of the amounts determined under those two subparagraphs would be considered to be the relevant *excluded profit amount*. Paragraph 1573 of the Explanatory Statement provides a description of how these provisions would apply in the context of a *withholding tax upward adjustment* and the same concepts apply in this context.

Paragraph 12

Definition of “Withholding Tax Downward Adjustment”

1417. Paragraph 12 contains the definition of *withholding tax downward adjustment*. The term is relevant in determining the *entity elimination profit (or loss)* of a Group Entity (see paragraph 1244 of this Explanatory Statement above) under Annex B Section 4(2). The adjustment seeks to align the *entity elimination profit (or loss)* with the corporate income tax base by taking into consideration situations where the Jurisdiction in which the Group Entity that received a Covered Payment is located has waived its right

to tax income related to a Covered Withholding Tax by providing double taxation relief. A Covered Withholding Tax is defined in Article 2 (see paragraph 71 of this Explanatory Statement).

1418. A *withholding tax downward adjustment* is only provided to the Group Entity that received the Covered Payment subject to a Covered Withholding Tax where the pre-conditions in the chapeau of paragraph 12 are met. This means that a *withholding tax downward adjustment* is only provided where a Covered Withholding Tax is withheld in respect of a Covered Payment paid to a Group Entity in a Period where the Group is a Covered Group. Where a Jurisdiction withholds tax that does not meet the definition of a Covered Withholding Tax, then no *withholding tax downward adjustment* is provided. Further, a *withholding tax downward adjustment* is only provided in instances where the Covered Payment is made to a Group Entity (the payee) located in a Jurisdiction where it is liable to tax on the related income, and that Jurisdiction has a comprehensive legal mechanism to avoid double taxation in respect of the Covered Withholding Tax. A Group Entity is considered liable to tax on the income where there is comprehensive taxation under the Jurisdiction's laws by reason of various criteria, irrespective of whether and how much tax is imposed. A Jurisdiction is considered to have a comprehensive legal mechanism to avoid double taxation in respect of the Covered Withholding Tax when it applies rules to eliminate juridical double taxation that are generally consistent with the credit method or the exemption method described in Article 23A or 23B of the OECD Model or UN Model. It does not matter whether these rules are contained in domestic law, in provisions included in bilateral or multilateral agreements to which the Jurisdiction is a party or in a combination of both. As rules to eliminate juridical double taxation vary considerably from Jurisdiction to Jurisdiction, it is also recognised that applying this condition does not require the consideration of the detailed rules on how to eliminate juridical double taxation provided by a Jurisdiction, nor undertaking investigations on the actual double tax relief position of the Group Entity in a Jurisdiction. Further, for purposes of paragraph 12, a Group Entity will be considered liable to tax on the income in a Jurisdiction that has a comprehensive legal mechanism to provide elimination of double taxation where the Group Entity is located in a Jurisdiction that, instead of taxing the income and providing relief through an ordinary corporate income tax system on business profits, implements a Qualifying Domestic Minimum Top-up Tax that takes into account withholding tax collected when calculating whether a top-up tax is payable. In cases where a Jurisdiction implements a domestic top-up tax that is not a Qualifying Domestic Minimum Top-up Tax then these conditions will not be satisfied under paragraph 12. In cases where the Group Entity is liable to tax on the income in a Jurisdiction that has a comprehensive legal mechanism to provide elimination of double taxation through an ordinary corporate income tax system on business profits, the implementation of a Qualifying Domestic Minimum Top-up Tax is not relevant for the purpose of applying the pre-conditions in the chapeau of paragraph 12.

1419. Where a Covered Payment is made from Group Entity A in Jurisdiction A to Group Entity B in Jurisdiction B and the tax authority in Jurisdiction A imposes a Covered Withholding Tax on the Covered Payment, a *withholding tax downward adjustment* will be recognised in the *entity elimination profit (or loss)* of Group Entity B provided that Group Entity B is liable to tax in Jurisdiction B and Jurisdiction B has a comprehensive legal mechanism to provide for the elimination of double taxation in respect of the Covered Withholding Tax. The same applies to a Covered Payment made by a third party to Group Entity B. The adjustment would continue to be applied to the *entity elimination profit (or loss)* of Group Entity B in the event that Group Entity B has a Taxable Presence in a third Jurisdiction (for example Jurisdiction C) that is subject to income tax with respect to the Covered Payment, as long as Group Entity B is liable to tax in Jurisdiction B and Jurisdiction B has a comprehensive legal mechanism to provide for the elimination of double taxation in respect of the Covered Withholding Tax.

1420. Where the pre-conditions in the chapeau of paragraph 12 are satisfied, subparagraphs (a) through (d) determine how the amount of the *withholding tax downward adjustment* is calculated for each relevant Period.

Subparagraph (a)

1421. Where the requirements of the chapeau are satisfied, subparagraph (a) provides that the *withholding tax downward adjustment* of a Group Entity that was the payee with respect to a Covered Payment for a Period is the sum of two elements. First, subdivision 12(a)(i) provides for inclusion of an amount equal to the *current withholding tax downward adjustment* with respect to each Covered Payment received by a Group Entity that was subject to a Covered Withholding Tax in the Period. The *current withholding tax downward adjustment* is determined using subparagraph (b). Second, subdivision 12(a)(ii) provides for the inclusion of *withholding tax downward spreading adjustments* which relate to Covered Payments made during prior Periods. How *withholding tax downward spreading adjustments* should be included is determined using subparagraphs (c) and (d).

Subparagraph (b)

1422. The *current withholding tax downward adjustment* with respect to a Covered Payment received by a Group Entity that was subject to a Covered Withholding Tax in the Period is calculated in accordance with subparagraph (b). It is equal to the *withholding tax downward amount* identified with reference to the most recent *tax liability determination* for the Covered Payment in the Jurisdiction where the Covered Withholding Tax is imposed (typically, the Jurisdiction where the payor is located) as of 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period. The term *tax liability determination* is defined in paragraph 13(g). In most instances, the applicable *tax liability determination* would be the original withholding tax collected by the payor of the Covered Payment (a Group Entity or third party) and remitted to the tax authorities with a self-assessed withholding tax filing. However, in some instances, it is possible that an amended self-assessed withholding tax filing could be filed by that payor entity prior to 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period and in that case that amended self-assessed withholding tax filing would be the applicable *tax liability determination* for the Period. In some cases a tax liability assessment could be raised by a tax administration prior to 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period and in that case that tax liability assessment may be the applicable *tax liability determination* for the Period. In instances where the payor of the Covered Payment is not a Group Entity the relevant *tax liability determination* could be made with respect to an Entity that is not a Group Entity (for example because of a joint liability with the Group Entity that is the payee).

1423. If no withholding tax has been collected on a Covered Payment or no *tax liability determination* with respect to a Covered Withholding Tax has been issued by the tax authorities 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period, there will be no adjustment for the payee Group Entity for its *entity elimination profit (or loss)* in that Period with respect to the Covered Payment and the *current withholding tax downward adjustment* will be zero.

1424. For purposes of assessing whether a *tax liability determination* exists in relation to a *withholding tax downward amount*, only determinations in the Jurisdiction where the Covered Withholding Tax is imposed are relevant. In some instances the *tax liability determination* will be made by a third-party payer of a Covered Payment

Subparagraph (c)

1425. Subparagraph (c) provides for *withholding tax downward spreading adjustments* that adjust the *entity elimination profit (or loss)* of the payee Group Entity if, as of the end of the current Period, the most recent *tax liability determination* in the Jurisdiction that imposed the Covered Withholding Tax with respect to a Covered Payment in a prior Period in which the Group was a Covered Group or a previously

unrecognised Covered Payment in a prior Period in which the Group was a Covered Group would result in a change in a *withholding tax downward amount* for that Covered Payment. In this way the relevant provisions are similar to the mechanism provided with respect to *taxable presence elimination profit or loss* (Annex B Section 4(3)), *profit allocation adjustment* (Annex B Section 4(7)), and *main entity taxable presence adjustment* (Annex B Section 4(3)), *withholding tax upward adjustment* (Annex B Section 6) respectively).

1426. In most cases, a *withholding tax downward spreading adjustment* will reduce the *entity elimination profit (or loss)* at Annex B Section 4(2) with respect to the Group Entity (i.e. the payee) where the adjustment is applied. However, in some limited cases the reverse may be observed. This would occur where a *tax liability determination* with respect to a Covered Withholding Tax results in a reduction in the *withholding tax downward amount* with respect to a Covered Payment. For example, consider a scenario where an initial self-assessed withholding tax filing relating to a Covered Payment in 2028 resulted in a *withholding tax downward amount* of EUR 1 million in 2028, then a tax administration assessment increased that to increase the *withholding tax downward amount* to EUR 2 million in 2029 and then a court decision reduced that *withholding tax downward amount* back to EUR 1 million in 2030. In this case, the *withholding tax downward amount* would reduce by EUR 1 million in 2030 and this reduction would be taken into account as a negative *withholding tax downward spreading adjustment* in 2030 that would increase *entity elimination profit (or loss)* in 2030.

1427. Subparagraph (c) requires that an amount will only be recognised in the Period under subparagraph (c) if at least 75 per cent of the additional tax liability or tax refund associated with the applicable *tax liability determination* is paid before the end of that Period.

1428. Where the taxpayer or tax administration has made no or insufficient payment following a *tax liability determination*, including in cases where it has lodged an appeal against the tax assessment or initiated compliance proceedings, the entire amount of the change in *withholding tax downward amount* will not (yet) be taken into account for purposes of calculating the *withholding tax downward amount* and accordingly determining the *entity elimination profit (or loss)*. Once at least 75 per cent of the additional tax or refund amount is paid in aggregate, for example in a case where the taxpayer decides to accept the tax assessment or loses the appeal and is compelled to make payment, the change in *withholding tax downward amount* from the *tax liability determination* must be recognised in that Period. A *tax liability determination* can therefore only impact the *entity elimination profit (or loss)* where at least 75 per cent of the additional tax is paid or at least 75 per cent of the refund is paid.

Box 27. Example – Withholding tax downward adjustments

- For example, the Amount A Tax Return and Common Documentation Package for the year ended 2029 was due on 31 December 2030. A relevant payor located in Jurisdiction S filed a withholding tax return in Jurisdiction S on 30 September 2030 with respect to a Covered Payment made in 2029 to a Group Entity located in Jurisdiction R. The amount of Covered Withholding Tax levied in Jurisdiction S is EUR 20 million and the corporate income tax rate applicable to profits in Jurisdiction R is 20% (refer to Annex B Section 4(13)(i)(i)), and paragraph 1471 of the Explanatory Statement]. In this case, the *withholding tax downward amount* that could give rise to a *withholding tax downward adjustment* for the Group Entity located in Jurisdiction R would be EUR 100 million (=20 million / 20%).
- In 2032, the tax authority of Jurisdiction S increased the amount of withholding tax by EUR 10 million with respect to the Covered Payment made in 2029 (so that the total withholding tax

levied by Jurisdiction S with respect to the Covered Payment was EUR 30 million). This would result in a change in *withholding tax downward amount* for the Group Entity located in Jurisdiction R. If the Covered Group did not make any payment in respect of that assessment during 2032, there would be no *withholding tax downward spreading adjustment* with respect to the Covered Payment relating to 2029 Period that would be recognised in the 2032 Period.

- However, if the Covered Group made at least 75 per cent payment with respect to the assessment during 2032, a *withholding tax downward spreading adjustment* would be recognised equal to EUR 50 million (=10 million / 20%). Part of this adjustment would be initially recognised in the 2032 Amount A Tax Return and Common Documentation Package of the Group Entity that received the Covered Payment and the remainder would be spread over three total periods because the determination giving rise to the adjustment relates to less than three periods (refer to paragraphs 1431 through 1440 of the Explanatory Statement for further details about spreading rules).

1429. Where the above described conditions with respect to subparagraph (c) are satisfied (i.e., a *tax liability determination* is made in the payor Jurisdiction in respect of a Covered Payment that changes the *withholding tax downward amount* with respect to the Group Entity that received the Covered Payment recognised in a prior Period in respect of that Covered Payment and at least 75 per cent of the additional tax or refund resulting from the *tax liability determination* is paid), the *tax liability determination* will be taken into account as a “withholding tax downward spreading adjustment” of the payee Group Entity that may be subject to spreading over multiple future Periods. Applicable spreading may be determined in one of three ways depending on the circumstances of the change, as clarified in subdivisions (i) through (iii).

1430. Subdivision (i) provides that if the change in the *withholding tax downward amount* is less than EUR 5 million, the entire change shall be taken into account in the current Period. This outcome will apply regardless of whether *withholding tax downward spreading adjustments* relating to that Covered Payment are still being recognised in the current Period from a *tax liability determination* in a prior Period which might apply where a prior change in *withholding tax downward amount* in excess of EUR 5 million that is subject to spreading under subdivision (ii) occurred in the previous Period whereas the current change is less than EUR 5 million.

1431. Subdivision (ii) provides that if the change in the *withholding tax downward amount* is greater than EUR 5 million, the change shall be taken into account partially in the current Period and partially in future periods.

1432. Subdivision (ii)(A) applies in cases where there has been a previous adjustment under subdivision (ii) for the same payee Group Entity in respect of the same Covered Payment and where all of the *withholding tax downward spreading adjustments* have not yet been taken into account. In that case, that new change in the *withholding tax downward amount* is combined with the remaining *withholding tax downward spreading adjustment* in respect of the prior Period that has not yet been included in determining the *entity elimination profit (or loss)* of the payee Group Entity for any Period. The net amount is spread equally over Periods beginning with the current Period and consisting of the greater of:

- Three total Periods;
- the number of Periods to which the determination giving rise to the current change relates; and

- the number of Periods over which the remaining *withholding tax downward spreading adjustment* from the prior change are spread.

1433. For example, if Jurisdiction S levied withholding tax in 2028 that resulted in a change in *withholding tax downward amount* of EUR 120 million in 2028 in respect of a Covered Payment made in 2026 tax year to the payee Group Entity located in Jurisdiction R, the *withholding tax downward spreading adjustment* would be made to the Group Entity in R over three Periods as the adjustment relates to a single tax year and the EUR 5 million materiality threshold is satisfied, assuming at least 75 per cent of the additional tax was paid in 2028. An adjustment of EUR 40 million would be made in the three Periods commencing from 2028. If, two years later in 2030, a subsequent amendment to the original assessment was made in Jurisdiction S resulting in a reduction in the *withholding tax downward amount* of EUR 10 million for the Group Entity located in Jurisdiction R in respect of the same Covered Payment and the 2026 tax year, clause (A) would apply. The net adjustment would be EUR 30 million (i.e. where the remaining amount in respect of the prior adjustment would be EUR 40 million (EUR 120 million less two years of spreading adjustments recognised in 2028 and 2029) less the new EUR 10 million downward adjustment) which would be required to be spread equally across three Periods. Three is the minimum number of Periods over which a *withholding tax downward spreading adjustment* may be spread under clause (A). That is greater than the number of Periods to which the 2030 adjustment relates and the number of remaining Periods over which the remainder of the 2028 adjustment will be made (in both cases, one Period)).

1434. For the purpose of applying the rules in paragraph 12(c)(ii), the number of Periods to which the determination giving rise to the current change relates should be interpreted having regard to the Explanatory Statement with regard to the definition of *tax liability determination* (see paragraph 1465).

1435. Commonly the number of Periods impacted by both the current change in *withholding tax downward amount* and the previously recognised *withholding tax downward amount* that has not yet been fully recognised will be the same. This might be because the second change relates to a challenge to an original tax assessment and the scope of both determinations is the same. Where this is the case, the re-setting of the applicable spreading period will result in a prolonging of the number of Periods over which the original adjustment is recognised.

1436. If a withholding tax adjustment was made by Jurisdiction S in 2034 resulting in a change in *withholding tax downward amount* of EUR 120 million for the payee Group Entity R Co located in Jurisdiction R in respect of a Covered Payment made by Group Entity S Co in Jurisdiction S in respect of the 2027 to 2032 tax years, the *withholding tax downward spreading adjustment* would be made over six Periods as the adjustment relates to six tax years. Assuming at least 75% of the additional tax was paid in 2034, a *withholding tax downward spreading adjustment* of EUR 20 million would be made for the Elimination Profit (or Loss) in Jurisdiction R in each of the six Periods commencing from 2034. If, two years later in 2036, a subsequent *tax liability determination* in Jurisdiction S resulting in a reduction in *withholding tax downward amount* of EUR 20 million was made in respect of the same transaction and the 2027 to 2032 tax years, clause (A) would apply. The net adjustment that would apply from 2036 made for Group Entity R would be EUR 60 million (i.e. where the remaining amount in respect of the prior adjustment would be EUR 80 million (EUR 120 million less two years of spreading adjustments recognised in 2034 and 2035) less the new EUR 20 million reduction in *withholding tax downward amount*) which would be required to be spread equally across six Periods. Six is the number of Periods to which the determination giving rise to the 2036 change relates (2027-2032). That is greater than the default three Periods and the number of Periods remaining for the 2034 adjustment (four Periods, assuming the refund is paid in 2036)).

1437. Subdivision (ii)(B) applies in all other cases that are not covered by clause (A) where the change in the *withholding tax downward amount* is greater than EUR 5 million. That would be the case if, for example, there has been no previous *withholding tax downward amount* in respect of the same Covered

Payment, or there has been such an adjustment, but the full amount of that prior adjustment has already been taken into account. In those cases, the adjustment is spread equally across a term beginning with the current Period and consisting of the greater of three Periods; and the number of Periods to which the determination giving rise to a change in the *profit allocation amount* relates.

1438. For example, if a *tax liability determination* resulting in a change in *withholding tax downward amount* of EUR 120 million was made by Jurisdiction S in 2030 in respect of a Covered Payment from S Co in Jurisdiction S to R Co in Jurisdiction R arising in 2028, that change in *withholding tax downward amount* would result in a *withholding tax downward spreading amount* in R Co under paragraph 12(a)(ii), provided that 75 per cent payment requirement is satisfied. Assuming that the *tax liability determination* was the first *tax liability determination* in respect of that Covered Payment after the Period that the transaction occurred, the *withholding tax downward adjustment* to Group Entity R in Jurisdiction R of EUR 120 million would be made to the *entity elimination profit (or loss)* of R Co located in Jurisdiction R. The inclusion would be required to be spread equally across three Periods because the adjustment relates to a single Period (2028). Accordingly, an adjustment of EUR 40 million would be included in the *entity elimination profit (or loss)* of R Co for three Periods commencing in 2030, assuming at least 75% of the tax would be paid in that year.

1439. Subdivision (iii) provides that if a Group Entity that is subject to *withholding tax downward spreading adjustments* under subdivision (ii) leaves the Covered Group in a Period and the full amount of the *withholding tax downward spreading adjustment* has not yet been taken into account, the remaining amount of the adjustment that has not been spread across prior Periods must be included in the *entity elimination profit (or loss)* in the Period that the Group Entity leaves the Covered Group. If the Group Entity that is subject to *withholding tax downward spreading adjustment* ceases to exist, then the requirement provided in subdivision (iii) will be deemed to be satisfied.

1440. For example, if an increase in *withholding tax downward amount* of EUR 9 million was recognised with respect to Jurisdiction A in 2028 in respect of a Covered Payment in respect of the 2027 tax year and the adjustment was spread over three Periods, an adjustment of EUR 3 million would be made each Period commencing in 2028 (assuming that at least 75% of the additional tax was paid in 2028). If, one year later in 2029, the Group Entity in respect of which the *withholding tax downward spreading adjustment* was made leaves the Covered Group, the remaining amount of the adjustment that has not been spread across prior Periods would be EUR 6 million (being EUR 9 million less EUR 3 million applied in 2028). Under subdivision (iii), that EUR 6 million must be included in the *entity elimination profit (or loss)* of the Group Entity for 2029.

Subparagraph (d)

1441. Subparagraph (d) is designed to deal with cases where a Covered Group comes in and out of scope of Amount A. It is intended to ensure that *tax liability determinations* with respect to Covered Payments that occurred when the Group was in scope of Amount A that are made during Periods when the Group is not in-scope of Amount A are taken into account when the Group subsequently comes back into scope of Amount A in specified cases. The provision will not apply if the most recent change in *withholding tax downward amount* occurred more than two Periods before the Group comes back into scope.

1442. With respect to a Covered Payment in a prior Period, a change in the *withholding tax downward amount* will be recognised in respect of that Covered Payment in the Period where conditions in subdivisions (i) and (ii) are satisfied.

1443. The first condition is that the Group was not a Covered Group in the immediately preceding Period. The second condition is that the most recent change in *withholding tax downward amount* prior to the Period with respect to the Covered Payment resulted from a *tax liability determination* during a Period when the Group was not a Covered Group and less than two years before the beginning of the Period. In those cases, the *withholding tax downward amount* in the Jurisdiction that imposed the Covered Withholding Tax in the Period will be deemed equal to the relevant *withholding tax downward amount* from the latest *tax liability determination* prior to the end of the current Period, less the relevant *withholding tax downward amount* determined from the latest *tax liability determination* with respect to that Covered Payment during a prior Period where the Group was a Covered Group.

1444. For example, a Group that was in-scope of Amount A in 2024 recognised a Covered Payment resulting in a *withholding tax downward amount* of EUR 100 million in 2024 for the Group Entity R Co in Jurisdiction R with respect to a Covered Payment paid by S Co in Jurisdiction S. The Group fell out of scope of Amount A in 2025. In 2030, the tax authority in Jurisdiction S levied additional withholding tax that increased the *withholding tax downward amount* in Jurisdiction R by EUR 30 million with respect to the Covered Payment made in 2024. If the Group came back into scope of Amount A in 2031 (less than two Periods after the prior change in *withholding tax downward amount* took place) the Covered Group would recognise an increase in the *withholding tax downward amount* in Jurisdiction R of EUR 30 million (assuming that at least 75% of the additional tax was paid). This adjustment would be subject to spreading treatment as described above commencing from 2031.

1445. In addition, there could be situations where both subparagraphs (c) and (d) apply to a Covered Payment in a given Period. In such a case, the net of the amounts determined under those two subparagraphs would be considered to be the relevant *withholding tax downward amount*. Paragraph 1573 of the Explanatory Statement provides a description of how these provisions would apply in the context of a *withholding tax upward adjustment* and the same concepts apply in this context.

Paragraph 13

Other definitions

1446. Paragraph 13 contains a number of definitions that apply with respect to this Section. Clarifications regarding those definitions are provided below.

Covered profit allocation transaction

1447. Subparagraph 13(a) provides the definition of the term *covered profit allocation transaction* that is relevant with respect to paragraphs 2(c) and 7. This definition is relevant for defining those transactions that may be subject to a *profit allocation adjustment*.

1448. A *covered profit allocation transaction* is a transaction that satisfies three criteria. First, the transaction must be between two or more Group Entities. Second the transaction must result in taxable income or tax deduction in one or more Group Entities. Third, the domestic law of one or more Jurisdictions in which the Group Entities or *taxable presences* are located specifies the basis for determining the taxable income or allowable deduction with respect to that transaction. Where a Qualifying Domestic Minimum Top-Up Tax or similar taxation applies to a Covered Group in a Jurisdiction and an amount of income or expense is attributed to a transaction between two or more Group Entities for determining relevant jurisdictional profits in the Jurisdiction for purposes of applying those rules such transaction will be deemed to be a *covered profit allocation transaction*.

1449. In cases where neither Group Entity (including their taxable presences) is subject to domestic tax law that specifies the basis for determining taxable income or allowable tax deduction with respect to that transaction (i.e. where neither entity nor its taxable presences are subject to profit allocation rules under domestic law that apply to that transaction), the treatment of a transaction in determining Entity Financial Accounting Profit (or Loss) in each Group Entity under an Acceptable Financial Accounting Standard is the treatment that is followed.

1450. The definition goes on to exclude a transaction if all income and expenses arising from the transaction would be recognised by Group Entities or *taxable presences* that are located in the same Jurisdiction and either included in the same tax consolidated group for domestic corporate income tax purposes, or are members of the same corporate income tax group and are permitted to surrender corporate income *tax losses* to one another for domestic corporate income tax purposes. The exclusion of such transactions can apply to multi-party transactions provided the terms of the exclusion are met by all parties to the transaction.

Covered tax treaty

1451. Paragraph 13(b) provides the definition of the term *covered tax treaty*, which is relevant to paragraph 5(c). This term is defined by reference to two other defined terms: Existing Tax Agreement (defined in Article 2(s)) and *covered tax agreement* (defined in Article 34(6)(b)).

Covered taxes

1452. Paragraph 13(c) provides the definition of the term “covered taxes”, which is relevant for the definition of a *flow-through entity* in paragraph 4, the location tiebreaker in paragraph 5(c)(i) and the definition of *taxable equity transaction adjustment* in paragraph 9. The term “covered taxes” includes several categories of taxes on income which are listed under subparagraphs (i) through (iv), but excludes tax on income collected by the payor in respect of a payment made to another person on income arising in the Jurisdiction where the payor is located (i.e. withholding taxes).

1453. Paragraph 13(c)(i) provides that the taxes recorded in the financial accounts of a Group Entity with respect to its income or profits or its share of the income or profits of a Group Entity in which it owns a Specified Equity Interest qualify as *covered taxes*. The definition encompasses not only taxes imposed on income at the time such income is derived but also taxes on the subsequent distribution of profits. The definition also includes taxes on the income of the Group Entity as well as its share of income of another Group Entity in which it owns a Specified Equity Interest. Thus, taxes imposed on the Group Entity’s share of undistributed profits from a *tax transparent entity* such as a partnership, taxes imposed under a CFC-regime, as well as taxes imposed on distributions from another Group Entity are *covered taxes* under paragraph 13(c)(i).

1454. A tax need not determine the taxpayer’s precise profit to qualify as a tax on income. Accordingly, the definition of *covered taxes* includes taxes that allow for a simplified estimate of net profit. For example, a tax on income that allows a standardised deduction in place of actual expenses is generally considered a tax on income if such standardised deduction is based on a reasonable method for estimating such expenses. A tax imposed on gross income or revenue without any deductions (i.e. a tax on turnover) would not be considered an tax on income. The definition of *covered taxes* therefore does not include a tax on a gross amount unless such a tax is in lieu of a tax on corporate income, as discussed below in connection with paragraph 13(c)(iii).

1455. Paragraph 13(c)(ii) provides that taxes on distributed profits are *covered taxes*. Some Jurisdictions impose taxes on income on corporations with the tax generally payable only when the corporation either

distributes profits to shareholders, is deemed to distribute profits to shareholders, or incurs certain non-business expenses. Such taxes also qualify as *covered taxes*.

1456. Paragraph 13(d)(iii) provides that taxes imposed in lieu of a generally applicable corporate income tax are *covered taxes*. A generally applicable corporate income tax could be one that applies to all resident corporations or one that typically applies to those resident corporations that are members of a large multinational group. A generally applicable corporate income tax would also include an income tax imposed on a corporation but which also applies to other taxable persons such as individuals.

1457. The “in lieu of” test includes Taxes that are not described in the generally applicable income tax definition but which operate as substitutes for such taxes. This does not include withholding taxes constituting a tax on income collected by the payor in respect of a payment made to another person on income arising in the Jurisdiction where the payor is located, which are excluded from the definition of *covered taxes* under the tailing provision.

1458. The “in lieu of” concept also covers Taxes that are imposed on an alternative basis (i.e. on a basis other than net income), such as Taxes based on the number of units produced or commercial surface area, and which are used as substitutes for a generally applicable income tax under the laws of the Jurisdiction. Where, for example, a Jurisdiction imposes a simplified methodology for calculating the income on a particular category of business or investment and this Tax is imposed in substitution for a generally applicable income tax, then that Tax falls within the definition of a Covered Tax.

1459. Paragraph 13(d)(iv) provides that taxes levied by reference to retained earnings and corporate equity, including a tax on multiple components based on income and equity, are *covered taxes*. Some Jurisdictions impose taxes on the net equity of a corporation in addition to or instead of corporate income tax. Some Jurisdictions impose taxes that have multiple components to the base. Where all of the components of the tax base relate to income or profit, the tax, as a whole, is included in the definition of *covered taxes*. Other taxes may be levied in respect of a corporation’s activities in a Jurisdiction and are administratively and conceptually part of the system of corporate taxation in these Jurisdictions but may include both an income and a non-income element. Where such taxes are predominately a tax on an Entity’s income and it would be administratively burdensome to split the tax into separate income and non-income components then such taxes should be treated, in full, as *covered taxes*.

1460. A number of commonly encountered taxes will not be included in the definition of *covered taxes*. These include consumption taxes, excise and other taxes on inputs, digital services taxes, stamp duties, ad valorem taxes, payroll taxes, other employment-based taxes and property taxes.

1461. Additionally, the definition excludes tax on income collected by the payor in respect of a payment made to another person on income arising in the Jurisdiction where the payor is located. This would prevent a Group Entity from being located in a Jurisdiction under the tiebreaker rule of paragraph 5(c)(i) simply because it has paid withholding taxes in that jurisdiction.

Elimination Eligible Prior Period

1462. Subparagraph (d) defines the term “eligible elimination prior period” to include each Period: (1) starting with the earliest Period, if any, that falls within specified time limits and for which there is an *unused elimination loss* in the Jurisdiction (irrespective of whether the Group was a Covered Group during that earlier Period), and (2) ending with the immediately preceding the current Period. This rule ensures that any prior Period(s) following the first loss-making Period is automatically treated as an eligible elimination prior period, regardless of whether such a prior period was profit- or loss-making. The consequence is that any elimination profit or loss (before deduction of *relevant elimination net losses*) reported by the Covered

Group in the Jurisdiction after that first loss Period is taken into consideration for the calculation of the amount of *eligible elimination net losses* that is deductible from the profit of a Period in the Jurisdiction. See paragraph 6 for further detail.

Main Entity

1463. Subparagraph (e) provides the definition of the term *main entity* that is relevant with respect to paragraph 2(i) and paragraphs 3 and 11 of this Section. The term “main entity” refers to the Group Entity that includes in its financial statements the Entity Financial Accounting Profit (or Loss) that has been attributed to a Taxable Presence in accordance with Paragraph 3.

Qualifying Reorganisation

1464. Subparagraph (f) provides the definition of the term “*qualifying reorganisation*”. Further discussion in relation to the types of arrangements that will be recognised as a *qualifying reorganisations* and therefore subject to the *qualifying reorganisation adjustment* is provided from paragraph 1366.

Tax Liability Determination

1465. Subparagraph (g) provides the definition of the term *tax liability determination* and is relevant for the purpose of determining any *taxable presence profit amount, profit allocation amount, excluded profit amount, withholding tax downward amount or withholding tax upward amount* in a Period. This term is defined to mean an original tax return, a self-amended tax return, an audit assessment issued by a tax administration, a determination by a court or other judicial body, a resolution under the mutual agreement procedure in a tax treaty, or any other determination by a judicial body, administrative body or competent taxing authority that determines the amount of the legal liability of the Group Entity to pay tax. It may also include a self-assessed withholding tax filing submitted by a payor different from the Group Entity payee, or a tax administration assessment in relation to a withholding tax. In the context of this definition, it is intended that the term other judicial body would refer to any entity empowered under relevant domestic law to issue a binding determination regarding a taxation liability that would not otherwise satisfy other aspects of this definition.

1466. A single *tax liability determination* may take the form of multiple separate tax assessments issued by a tax administration in some instances. For example, in a case where an audit covers four years and adjustments are made with respect to all four years under review the actual legal instrument giving rise to the amended assessment might take the form of four separate assessment notices. In such a case, the question of whether one or more *tax liability determinations* has taken place will be assessed with regard to the interrelationship between the assessments in question rather than the assessment notices issued.

1467. A *tax liability determination* would include a determination by the Amount A *determination panel* with respect to issues relating to Amount A. It is intended that an event would constitute a *tax liability determination* where that event provides a legal obligation of either the taxpayer or the tax administration to make a tax payment, provide a tax refund or pay or provide an altered amount with respect to an outstanding taxation obligation or refund.

Tax Losses

1468. Subparagraph (h) provides the definition of the term *tax losses*. In respect of an Entity, the amount of *tax losses* designates the amount of losses of all types, incurred in a Period and available for deduction in a subsequent Period, recognised for tax purposes in the Jurisdiction where that Entity is located and taken into account in calculating the most recent legally enforceable *tax liability determination*

1469. The term “tax losses” is used exclusively for the purpose of applying the materiality threshold, to determine whether the Covered Group may opt-out of deducting *transferred losses* arising from a particular *eligible business combination* or *eligible division*. Where the aggregate amount of “tax losses” of the Entities of the transferred group, entity or *predecessor group* in a Jurisdiction are lower than the threshold amount, the Covered Group may elect to opt-out of deducting *transferred losses* in respect of that transfer. See paragraph 6(b)(iii)(B) for further detail.

Withholding Tax Downward Amount

1470. Subdivision (i) provides the definition of the term “withholding tax downward amount” for purposes of applying a *withholding tax downward adjustment* to a Group Entity that received a Covered Payment subject to a Covered Withholding Tax under Annex B Section 4(12). This amount is defined as the lower of the calculations in subdivisions (i) and (ii).

1471. The calculation of the amount under subdivision (i) can be broken down into two parts. First, the amount of the Covered Withholding Tax imposed by a Jurisdiction in the latest *tax liability determination* is divided by the higher of 15 per cent and the generally applicable rate of the Party that would have been imposed on business profits of an enterprise carried on by a body corporate with the same relevant characteristics. The latter rate is deliberately described through a replication of the terminology used in Article 20(1) which defines the generally applicable rate for purposes of taxing Amount A profits, and hence the commentary and guidance from paragraphs 559 through 566 are also relevant for the purpose of defining the rate used in the divisor under subdivision (i). This means this rate takes into account both national and subnational taxes of a Jurisdiction where subnational taxes apply to business profits in the same way as federally levied income tax (see paragraphs 559 through 566 of this Explanatory Statement). Where the generally applicable income tax rate is less than 15 per cent then the 15 per cent provided in subparagraph (i) will apply. Therefore, the 15 per cent rate effectively functions as a rate “floor” for purposes of the calculation in subparagraph (i).

1472. The division by the higher of these rates is provided to convert the amount of the Covered Withholding Tax (i.e. a tax amount) that is relevant in the calculation of the *withholding tax downward adjustment* into a profit equivalent amount. This conversion is necessary as both the elimination of double taxation system under Article 9 through 11 and *marketing and distribution profits safe harbour adjustment* mechanism under Article 5, for which the *withholding tax downward adjustment* applies, function based on jurisdictional profit amounts rather than tax amounts.

1473. The calculation of the amount under subparagraph (ii) is equal to the amount of the Covered Payment after deducting an amount equal to 30 per cent of the amount of the Covered Payment. This result of the calculation under subparagraph (b) effectively provides a cap on the amount of the *withholding tax downward adjustment* where the calculation under subparagraph (a) would otherwise result in an amount which is a higher amount.

1474. For purposes of determining the *withholding tax downward amount*, only *tax liability determinations* that determine the quantum of withholding tax liability in the Jurisdiction imposing the Covered Withholding Tax are relevant.

Unused Elimination Loss

1475. Subparagraph (j) defines the term “unused elimination loss” as an elimination loss of a prior period in the Jurisdiction that has not been offset by elimination profit of subsequent Period(s) in the Jurisdiction, before deduction of any *relevant elimination net losses* in such Period(s). In computing *unused elimination losses*, elimination losses are used in the chronological order of the prior periods in which they arise to

offset elimination profit of prior periods. An “unused elimination loss” is therefore an amount that may give rise to a “relevant elimination net loss”, deductible in the current Period. See paragraph 6 for further detail.

Paragraph 14

1476. Where an incorporated Joint Venture is subject to joint control by a Group Entity that incorporated Joint Venture is considered to be a Group Entity for purposes of this Annex B Section 4 (and for purposes of Article 12 and 13, and Annex B Section 5). Paragraph 14 contains rules that define the *entity elimination profit (or loss)* for such an incorporated Joint Venture.

1477. Subparagraphs (a) through (c) describe the steps to be followed for this purpose. First, under subparagraph (a) the relevant Entity Financial Accounting Profit (or Loss) shall be determined in accordance with the audited financial statements prepared for that incorporated Joint Venture under an Acceptable Financial Accounting Standard. Second, under subparagraph (b) adjustments described in Paragraph 2 would be applied to convert the Entity Financial Accounting Profit (or Loss) figure for the incorporated Joint Venture to the *entity elimination profit (or loss)* figure that would be determined for that Joint Venture if it was not subject to third party ownership interests (i.e., if it were wholly owned by the Covered Group). Finally, under subparagraph (c) adjustments would be applied to the figure determined under subparagraph (b) to apply a proportionate reduction to only recognise the relative proportion controlled by the Covered Group.

Section 5 – Return on Depreciation and Payroll

Paragraph 1

Return on Depreciation and Payroll of a Covered Group

1478. Paragraph 1 provides that for purposes of the Convention, the “return on depreciation and payroll” of a Covered Group for a Period is the Adjusted Profit Before Tax of the Covered Group for the Period (calculated per Annex B Section 2) divided by the sum of the Covered Group’s *accounting depreciation* (calculated per paragraph 5(a)) and *accounting payroll* (calculated per paragraph 5(i)) for the Period. This defined term is relevant in the context of Article 11 to allocate the obligation to eliminate double taxation with respect to *Amount A relief amount*.

1479. For instance, if the Adjusted Profit Before Tax of the Covered Group for the Period is EUR 50 billion, the Covered Group’s *accounting depreciation* for the Period is EUR 20 billion, and the Covered Group’s *accounting payroll* for the Period is EUR 10 billion, then the Return on Depreciation and Payroll of a Covered Group for the Period will be 167% (= EUR 50 billion / (EUR 20 billion + EUR 10 billion)).

Paragraph 2

Jurisdictional Return on Depreciation and Payroll

1480. Paragraph 2 provides that for purposes of the Convention, the “jurisdictional return on depreciation and payroll” of a Covered Group for a Period in a Jurisdiction is the *elimination profit (or loss)* of the Covered Group for the Period in that Jurisdiction (calculated per Annex B Section 4) divided by *jurisdictional depreciation and payroll* of the Covered Group for the Period in that Jurisdiction (calculated per paragraph 3). This defined term is relevant in the context of Article 11 to allocate the obligation to eliminate double

taxation with respect to *Amount A relief amount* because Jurisdictional Return on Depreciation and Payroll constitutes the basis to calculate Tiers under Article 11(6) through (14).

Paragraph 3

Jurisdictional Depreciation and Payroll

1481. Paragraph 3 specifies that for purposes of the Convention, the “jurisdictional depreciation and payroll” of a Covered Group for a Period in a Jurisdiction is the sum of four separate elements. Two elements are relevant to depreciation and other two elements are relevant to payroll (moreover, two elements are relevant to entities and other two elements are relevant to taxable presence). Each of these elements can be determined based on definitions included in paragraph 5.

- *entity depreciation* of each Group Entity located for the Period in that Jurisdiction;
- *taxable presence depreciation* of each Taxable Presence located for the Period in that Jurisdiction;
- *entity payroll* of each Group Entity located for the Period in that Jurisdiction; and
- *taxable presence payroll* of each Taxable Presence located for the Period in that Jurisdiction.

1482. Where a Covered Group includes multiple Group Entities or multiple Taxable Presences within a given Jurisdiction it will be necessary for the Covered Group to determine applicable depreciation and payroll amounts for each and add these together.

Paragraph 4

Deemed Depreciation and Payroll for Relocated or Discontinued Operations

1483. Paragraph 4 provides a specific rule to deal with instances where a Group Entity or *taxable presence* may be attributed *entity elimination profit (or loss)* or *taxable presence elimination profit (or loss)* in a period where it has either since relocated to another Jurisdiction or has ceased to operate. This might occur by virtue of adjustments within the rules on *elimination profit (or loss)* that require change in *taxable presence profit amount, profit allocation amount, and excluded profit amount* to be recognised in a Jurisdiction in a period in which the *taxable presence profit amount, profit allocation amount, and excluded profit amount* changed.

1484. For example, consider Entity A that was located in Jurisdiction A in 2028 and relocated to Jurisdiction B in 2029. In the event that Jurisdiction A imposes a *profit allocation adjustment* Annex B Section 4(7) on Entity A with respect to a *covered profit allocation transaction* that occurred during 2028 and that adjustment was imposed and paid in 2032, an Elimination Profit (or Loss) adjustment would be recognised for a deemed *taxable presence* of Entity A in Jurisdiction A in the 2032 period despite the Group Entity or *taxable presence* having ceased to operate in that Jurisdiction.

1485. Where such a scenario occurs, in the absence of an adjustment to *jurisdictional depreciation and payroll*, the ratio of *elimination profit (or loss)* to depreciation and payroll of the Group Entity or *taxable presence* might be infinite because no depreciation and payroll would otherwise exist for that Group Entity or *taxable presence*. Where this is the case, Jurisdiction A might be required to provide relief in the form of elimination of double taxation equal to the entire amount of the tax adjustment imposed unless an adjustment is performed to the depreciation and payroll of the deemed taxable presence in Jurisdiction A.

1486. To address this scenario, paragraph 4 provides that where a Group Entity or a *taxable presence* is subject to a *profit allocation adjustment* or *main entity taxable presence adjustment*, or recognises *taxable presence elimination profit (or loss)* in the Period and that Group Entity or *taxable presence* is either located in another Jurisdiction during the Period or has ceased to operate in that Jurisdiction during the Period, an amount of depreciation and payroll will be deemed for that Group Entity or *taxable presence*. To determine the amount of that deemed depreciation and payroll, a formula is applied that seeks to approximate the Return on Depreciation and Payroll of that Group Entity or *taxable presence* in preceding periods.

1487. The deemed amount of *entity depreciation* and *entity payroll*, or *taxable presence depreciation* and *taxable presence payroll* is determined as follows. The *entity elimination profit (or loss)* or *taxable presence elimination profit (or loss)* in the Period is first divided by the sum of *entity elimination profit (or loss)* or *taxable presence elimination profit (or loss)* in the four most recent Periods that the Group Entity or *taxable presence* was operating and located in the Jurisdiction. The resulting number is then multiplied by the sum of *entity depreciation* and *entity payroll* or *taxable presence depreciation* and *taxable presence payroll* in the four most recent Periods that the Group Entity or *taxable presence* was operating and located in the Jurisdiction.

1488. For instance, suppose the same example as paragraph 1484 above, and the *entity elimination profit* of Entity A in 2032 was EUR 20 million. If the sum of *entity elimination profit* of Entity A from 2028 to 2031 were EUR 100 million, and the sum of *entity depreciation* and *entity payroll* of Entity A from 2028 to 2031 were EUR 30 million, then the amount of *entity depreciation* and *entity payroll* of Entity A will be deemed as EUR 6 million in 2032 under paragraph 4.

1489. Identification of the four most recent Periods that the Group Entity or *taxable presence* was operating and located in the Jurisdiction, will depend on whether the Group Entity or *taxable presence* has ceased operation entirely or relocated. In cases where a relocation has occurred, this will be deemed to take place on the date that the Group Entity or *taxable presence* is no longer located in that Jurisdiction based on the location test included in Annex B Section 4(5). In cases where operations have ceased, the date of ceasing operations would typically be identified based on the date of last recorded third party revenues or last observed performance of activities by *eligible personnel* that resulted in *eligible payroll costs* being incurred.

Paragraph 5

1490. Paragraph 5 contains a number of definitions that are relevant for purposes of the Convention.

Accounting Depreciation

1491. *Accounting depreciation* is defined in paragraph 5(a) as the reduction in carrying value of *eligible assets* taken into account in determining the Entity Financial Accounting Profit (or Loss) of a Group Entity for a Period. This reduction in carrying value must result from depreciation, amortisation, depletion or impairment, including any such amount attributable to capitalisation of payroll expense. In this way, *accounting depreciation* is not strictly limited to expenses that are characterised as depreciation in financial statements but it extends to all forms of depletion in accounting carrying value relating to those defined *eligible assets*. *Accounting depreciation* is determined based on those entity financial statements prepared for the purpose of preparing Consolidated Financial Statements and used in determining *entity elimination profit (or loss)*.

1492. In relation to a *regulated financial institution* defined under Annex C Section 2(3)(a) or an *extractives entity* defined under Annex C Section 3(2)(c), no *accounting depreciation* is determined.

Entity Depreciation

1493. *Entity depreciation* is defined in paragraph 5(b). It is determined by applying a number of adjustments to the *accounting depreciation* determined above. Similar to *accounting depreciation* explained in paragraph 1491 of the Explanatory Statement, no *entity depreciation* is determined for a *regulated financial institution* defined under Annex C Section 2(3)(a) or an *extractives entity* defined under Annex C Section 3(2)(c).

1494. Subdivision (i) includes an adjustment to exclude an amount of *entity depreciation* that corresponds to the *main entity taxable presence adjustment* in Annex B Section 4(11). This adjustment to *entity depreciation* is determined by first identifying the *taxable presence depreciation* attributed to the *taxable presence* in question (refer paragraph 5(c)) and then applying an adjustment factor to exclude that *taxable presence depreciation* amount for purposes of reducing the *entity depreciation* in the *main entity*. The adjustment factor is equal to *the main entity taxable presence adjustment* under Annex B Section 4(11) in the Period divided by the *taxable presence elimination profit (or loss)* of the *taxable presence* in the Period. However, the adjustment factor cannot exceed 1. In cases, where the *main entity taxable presence adjustment* is equal to or greater than the *taxable presence elimination profit (or loss)* this factor will be 1 and therefore the whole amount of *taxable presence moveable property depreciation* recognised in the *taxable presence* will be excluded from the *main entity*. In cases where no *main entity taxable presence adjustment* is recognised, the adjustment factor will be 0 and no downward adjustment to *entity depreciation* will be recognised in the *main entity* in recognition of the fact that the whole amount of entity profit is subject to tax in the location of the *main entity* notwithstanding the taxing rights exercised in *taxable presence* Jurisdiction. In cases where the adjustment factor is between 0 and 1 this reflects a scenario where some but not all of the *taxable presence* profits are subject to a corresponding downward adjustment in the *entity elimination profit (or loss)* of the *main entity*. In such cases it would make sense to reduce the *entity depreciation* of the *main entity* in a corresponding proportion.

1495. Next, subdivisions (ii) through (viii) include a number of adjustments to ensure consistency between the *elimination profit (or loss)* determination under Annex B Section 4 and the *jurisdictional depreciation and payroll* determination. These adjustments include the *acquired equity basis adjustment* under Annex B Section 4(2)(b)(i), *asset fair value or impairment adjustment* under Annex B Section 4(2)(b)(vi), *profit allocation adjustment* under Annex B Section 4(2)(c), *prior period adjustment* under Annex B Section 4(2)(d), *qualifying reorganisation adjustment* under Annex B Section 4(2)(e), *taxable equity transaction adjustment* under Annex B Section 4(2)(g), and *tax fair value adjustment* under Annex B Section 4(2)(h). These adjustments require that the amount of *entity depreciation* for purposes of this Section should be determined taking account of adjustments to the basis of relevant assets for the purpose of determining *entity elimination profit (or loss)* under Annex B Section 4 rather than the basis applicable for Consolidated Financial Statements.

1496. Finally, subdivision (ix) provides that depreciation derived from Joint Ventures and Joint Operations that are not *regulated financial institutions* or *extractives entities* are included in the calculation of *entity depreciation* in the same proportion as the Group's share of profit or loss derived from the Joint Operation or the Joint Venture. This adjustment is similar to the adjustment made to Adjusted Revenues in Article 2(c)(iv), as explained in paragraphs 53 and 54 of the Explanatory Statement. The definitions of a Joint Venture and a Joint Operation are provided in Articles 2(y) and (z), and paragraphs 115 through 117 of the Explanatory Statement. A similar adjustment is made to *entity payroll* in paragraph 5(j)(v).

Taxable Presence Depreciation

1497. *Taxable presence depreciation* of a *taxable presence* for a Period in a Jurisdiction is defined in paragraph 5(c). It is the sum of *taxable presence immovable property depreciation* defined in paragraph 5(d) and *taxable presence movable property depreciation* defined in paragraph 5(e) for the Period.

Taxable Presence Immovable Property Depreciation

1498. *Taxable presence immovable property depreciation* of a *taxable presence* for a Period in a Jurisdiction is defined in paragraph 5(d). It means all *entity depreciation* of a Group Entity that relates to *immovable property* located in the Jurisdiction of the Taxable Presence. *Immovable property* is separately defined in Annex D Section 7(d).

Taxable Presence Movable Property Depreciation

1499. The calculation of the *taxable presence movable property depreciation* of a *taxable presence* for a Period is defined in paragraph 5(e). The approach used to determine this amount depends on whether financial statements have been prepared with respect to a *taxable presence* that are followed for the purpose of determining the *taxable presence elimination profit (or loss)* of that *taxable presence*.

1500. Paragraph 5(e)(i) provides that if financial statements are prepared with respect to a *taxable presence*, the *taxable presence movable property depreciation* will be equal to the portion of *entity depreciation* that relates to *movable property* that is attributed to the *taxable presence* in these financial statements. The definition therefore seeks to align the computation of the *taxable presence movable property depreciation* with the corresponding allocation made in the relevant financial statements where applicable, provided that these financial statements are followed by the Jurisdiction of the *taxable presence* for the purpose of determining the *taxable presence elimination profit (or loss)*. The term “entity depreciation” is defined in paragraph 5(b) and the term “movable property” is defined in paragraph 5(h). The term “taxable presence elimination profit (or loss)” is defined in Annex B Section 4(3).

1501. In all other cases than paragraph 5(e)(i), where such financial statements do not exist or are not followed for the purpose of determining the *taxable presence elimination profit (or loss)* of that *taxable presence* in the Period, paragraph 5(e)(ii) provides that the *taxable presence movable property depreciation* depends on the respective *elimination profit (or loss)* of the *taxable presence* and the *main entity*.

Box 28. Example –Calculating taxable presence movable property depreciation under paragraph 5(e)

Calculation based on paragraph 5(e)(i)

For example, suppose a *main entity* of a Covered Group (i.e., Entity A) owns Equipment X with an *entity depreciation* of EUR 10 000 for Period 1, and Equipment X is attributed to Entity A’s *taxable presence* located in Jurisdiction X in its financial statements that are followed for domestic income tax purposes. Then, *taxable presence movable property depreciation* of Entity A’s *taxable presence* for Period 1 in Jurisdiction X would be EUR 10 000.

Calculation based on paragraph 5(e)(ii)

For instance, suppose that the financial statement of a Covered Group does not exist for the *taxable presence* of Entity B, or are not followed for domestic income tax purposes. If the *entity depreciation* of

Entity B for Period 1 were EUR 50 000, and the *entity depreciation* that relates to *immovable property* were EUR 45 000, then EUR 5 000 (=EUR 50 000 – EUR 45 000) would be the portion of *entity depreciation* that relates to *movable property* (assuming no adjustment in paragraph 5(b)(i)).

	Amount
<i>Entity depreciation</i>	EUR 50 000
<i>Entity depreciation that relates to immovable property</i>	EUR 45 000
<i>Entity depreciation that relates to movable property</i>	EUR 5 000 (=EUR 50 000 – EUR 45 000)

If the *taxable presence elimination profit* is EUR 3 million and the *entity elimination profit* of Entity B is EUR 10 million, *taxable presence movable property depreciation* of Entity B would be EUR 1 500 (= EUR 5 000 X EUR 3 million / EUR 10 million).

	Amount
Taxable presence elimination profit	EUR 3 million
Elimination profit of Entity B	EUR 10 million
<i>Taxable presence movable property depreciation</i>	EUR 1 500 (=EUR 5 000 X 3 million / 10 million)

1502.

1503. The starting point for this calculation is the *entity depreciation* of the relevant *main entity* minus the *entity depreciation* that relates to *immovable property* (defined in paragraph 5(g) and Annex D Section 7(d)) and excluding the adjustment included in paragraph 5(b)(i). This portion of the *entity depreciation* that relates to *movable property* is then multiplied by the *taxable presence elimination profit (or loss)* divided by the *entity elimination profit (or loss)* of the *main entity* before the *main entity taxable presence adjustment* and excluding the adjustment included in paragraph 5(b)(i). The *taxable presence movable property depreciation* therefore will constitute a portion of the *movable property entity depreciation* excluding the adjustment included in paragraph 5(b)(i) in the same proportion as the *taxable presence elimination profit (or loss)* forms part of the total *entity elimination profit (or loss)*.

1504. However, in some instances the quantitative analysis described above may lead to inappropriate outcomes without any further specifications. The definition therefore ensures that the *taxable presence movable property depreciation* will not be less than zero by specifying that it shall be equal to zero where the *taxable presence elimination profit (or loss)* is negative. Additionally, the *taxable presence movable property depreciation* cannot exceed the *entity depreciation* of the relevant *main entity* prior to any adjustment under paragraph 5(b)(i) and excluding all *entity depreciation* that relates to *immovable property*.

Eligible Assets

1505. The term “eligible asset” is defined in paragraph 5(f) and identifies those assets relevant for purposes of determining *entity depreciation*. This term is defined to refer to the following types of assets and specifically excludes property that is held for sale or investment:

- property, plant, and equipment;
- natural resources; and
- a licence or similar arrangement from the government for the use of *immovable property* or exploitation of natural resources that entails significant investment in tangible assets.

1506. The meaning of “property, plant, and equipment” provided in paragraph 5(f)(i) would be interpreted in accordance with *acceptable financial accounting standards* as defined in Article 2(a).

1507. The meaning of “natural resources” provided in paragraph 5(f)(ii) would be interpreted in accordance with ordinary meaning, and generally refers to materials or substances drawn from nature that can be exploited for economic gain.

1508. Paragraph 5(f)(iii) provides that a licence or similar arrangement from the government for the use of *immovable property* or exploitation of natural resources would qualify for the *eligible asset* if it entails significant investment in tangible assets. For instance, if a construction company licences the right to utilise the land from the government to construct a building, such a license would entail significant investment in the land, and thus the license would qualify for the *eligible asset*.

Immovable Property

1509. Paragraph 5(g) provides that the term “immovable property” has the meaning assigned to it in Annex D Section 7(d). The meaning of *immovable property* is discussed in paragraph 2508.

Movable Property

1510. Paragraph 5(h) provides that the term “movable property” means all property that is not *immovable property*, as defined in paragraph 5(g).

Accounting Payroll

1511. *Accounting Payroll* of a Group Entity is defined in paragraph 5(i) as *eligible payroll costs* (defined in paragraph 5(l)) of *eligible personnel* (defined in paragraph 5(m)) that perform activities for the Group Entity, other than a *regulated financial institution* or an *extractives entity*, taken into account in determining the Entity Financial Accounting Profit (or Loss) of a Group Entity for a Period. *Accounting payroll* is determined based on those entity financial statements prepared for purposes of preparing Consolidated Financial Statements and used in determining *entity elimination profit (or loss)*.

1512. Similar to *accounting depreciation* or *entity depreciation*, no *accounting payroll* is determined in relation to a *regulated financial institution* or an *extractives entity*.

Entity Payroll

1513. *Entity payroll* is defined in paragraph 5(j) and is determined by applying a number of adjustments to the *accounting payroll* determined above. Similar to *accounting payroll*, no *entity payroll* is determined for a *regulated financial institution* or an *extractives entity*.

1514. Subdivision (i) includes an adjustment to exclude *eligible payroll costs* (defined in paragraph 5(l)) that are not recognised as expenses in the Entity Financial Accounting Profit (or Loss) in the Period and included in the carrying value of *eligible assets*. Deducting such *eligible payroll costs* intends to prevent double counting of such costs.

1515. Subdivision (ii) includes an adjustment to exclude an amount of *entity depreciation* that corresponds to *the main entity taxable presence adjustment* in Annex B Section 4(11). This adjustment to *entity payroll* is determined by first identifying the *taxable presence payroll* attributed to the *taxable presence* in question (refer paragraph 5(k)) and then applying an adjustment factor to exclude that *taxable presence payroll* amount for purposes of reducing the *entity payroll* in the *main entity*. The adjustment factor is equal to the *main entity taxable presence adjustment* under Annex B Section 4(11) in the Period divided by the *taxable presence elimination profit (or loss)* of the *taxable presence* in the Period. However, the adjustment factor cannot exceed 1. In cases, where the *main entity taxable presence adjustment* is equal to or greater than the *taxable presence elimination profit (or loss)* this factor will be 1 and therefore the whole amount of *taxable presence payroll* recognised in the *taxable presence* will be excluded from the *main entity*. In cases where no *main entity taxable presence adjustment* is recognised in the *main entity*, the adjustment factor will be zero and no downward adjustment to *entity payroll* will be recognised in the *main entity* in recognition of the fact that the whole amount of entity profit is subject to tax in the location of the *main entity* notwithstanding the taxing rights exercised in taxable presence jurisdiction. In cases where the adjustment factor is between 0 and 1 this reflects a scenario where some but not all of the *taxable presence* profits are subject to a corresponding downward adjustment in the *entity elimination profit (or loss)* of the *main entity*. In such cases it would make sense to reduce the *entity payroll* of the *main entity* in a corresponding proportion.

1516. Next, similar to what is indicated in paragraph 1495 of the Explanatory Statement, subdivisions (iii) and (iv) include adjustments to ensure consistency between the *elimination profit (or loss)* determination under Annex B Section 4 and the jurisdictional *depreciation and payroll* determination. These adjustments include Stock Based Compensation under Annex B Section 4(2)(b)(iii) and (iv), and *prior period adjustment* under Annex B Section 4(2)(d). These adjustments require that the amount of *entity payroll* for purposes of this Section 5 should be determined taking account of adjustments to the basis of relevant assets for the purpose of determining *entity elimination profit (or loss)* under Annex B Section 4 rather than the basis applicable for Consolidated Financial Statements.

1517. Finally, subdivision (v) provides that *accounting payroll* derived from Joint Ventures and Joint Operations that are not *regulated financial institutions* or *extractives entities* are included in the calculation of *entity payroll* in the same proportion as the Group's share of profit or loss derived from the Joint Operation or the Joint Venture. This adjustment is similar to the adjustment made to Adjusted Revenues in Article 2(c)(iv), as explained in paragraphs 53 and 54 of the Explanatory Statement. The definitions of a Joint Venture and a Joint Operation are provided in Articles 2(y) and (z), and paragraphs 115 through 117 of the Explanatory Statement. A similar adjustment is made to *entity depreciation* in paragraph 5(b)(ix).

Taxable Presence Payroll

1518. The calculation of the *taxable presence payroll* of a *taxable presence* for a Period depends on whether financial statements have been prepared with respect to a *taxable presence* that are followed for the purpose of determining the *taxable profit amount*, *profit allocation amount*, and *excluded profit amount* of that *taxable presence*. Paragraph 5(k)(i) provides that if this is the case, the *taxable presence payroll* will be equal to the portion of *entity payroll* that is attributed to the *taxable presence* in these financial statements. The definition therefore seeks to align the computation of the *taxable presence payroll* with the corresponding allocation made in the relevant financial statements where applicable, provided that these financial statements are followed by the Jurisdiction of the *taxable presence* for the purpose of

determining the *taxable profit amount*, *profit allocation amount*, and *excluded profit amount*. The term “entity payroll” is defined in paragraph 5(j) and the term “movable property” is defined in paragraph 5(h). The terms “taxable profit amount, profit allocation amount, and excluded profit amount” are defined in paragraphs 3(b), 7(b), and 11(b) respectively.

1519. In all other cases, paragraph 5(e)(ii) provides that the *taxable presence payroll* depends on the respective Elimination Profit (or Loss) of the Taxable Presence and the *main entity*. The starting point for this calculation is the *entity payroll* of the relevant *main entity* excluding the adjustment included in paragraph 5(j)(ii). This payroll amount is then multiplied by the *taxable presence elimination profit (or loss)* divided by the *entity elimination profit (or loss)* of the *main entity* before the *main entity taxable presence adjustment*. The *taxable presence payroll* therefore will constitute a portion of the *entity payroll* in the same proportion as the *taxable presence elimination profit (or loss)* forms part of the total *entity elimination profit (or loss)*.

1520. However, in some instances the quant analysis described above may lead to inappropriate circumstances without any further specifications. The definition therefore ensures that the *taxable presence payroll* will not dip below zero by specifying that it shall be equal zero where the *taxable presence elimination profit (or loss)* is negative. Additionally, the *taxable presence payroll* cannot exceed the *entity payroll* of the relevant *main entity* prior to any adjustment under paragraph 5(j)(ii).

Eligible Payroll Costs

1521. The definition of “eligible payroll costs” of a Group Entity for a Period is included in paragraph 5(l). The term is relevant for the calculation of “accounting payroll” under paragraph 5(i) which in turn contributes to the calculation of the Return on Depreciation and Payroll under paragraph 1. The amount of *eligible payroll costs* and the Period in which they are recognised is determined in accordance with the definition of “entity payroll” in paragraph 5(j), which in turn is based upon “accounting payroll” defined in paragraph 5(i).

1522. There are three categories of costs included within the definition of *eligible payroll costs*. The first category, in paragraph 5(l)(i), covers salaries, wages, stock-based compensation and other similar remuneration. Those expenses must relate to *eligible personnel* of the Group Entity. In most instances, eligible payroll costs within this category will be applicable in instances where the *eligible personnel* in question is an employee of the Group Entity because costs of this kind are rarely paid by a Group Entity that is not the employer. The term “salaries, wages, stock-based compensation and other similar remuneration” includes benefits in kind that meet the conditions of subdivision (i) and therefore includes remuneration such as the use of a residence or automobile, health or life insurance coverage and club memberships. The term also includes contributions to a *pension fund*, or other retirement benefits, bonuses and other types of allowances.

1523. Subdivision 5(l)(ii) provides that *eligible payroll costs* include remuneration provided to another entity as compensation for activities performed by *eligible personnel* of the Group Entity. In this context remuneration provided to another entity includes remuneration provided to the individual that performed the relevant activities, to the entity that is the legal employer of the individual in question, or remuneration provided to a third party as compensation for the activities performed by the *eligible personnel* in question. In most instances, *eligible payroll costs* within this category will be applicable in instances where the *eligible personnel* in question is an employee of another Group Entity or a third party because costs of this kind are rarely paid by a Group Entity that is the employer. The term “remuneration” in this context includes benefits in kind financial or other compensation provided in exchange for the services performed by the *eligible personnel*.

1524. The term does not include onward amounts paid by the person deriving that income to other individuals who perform the relevant services. For example, if the *eligible payroll costs* of Group Entity A relate to costs a corporate entity (Group Entity B), only the amounts included in the *entity elimination profit (or loss)* of Group Entity A are *eligible payroll costs*. The *eligible payroll costs* do not include any amounts paid by Group Entity B to individuals that perform the relevant services for Group Entity A.

1525. Lastly, paragraph 5(l)(iii) provides that payroll and employment taxes, and employer social security contributions with respect to *eligible personnel* are *eligible payroll costs*. This category includes taxes on the total amounts of wages, salaries or other similar remuneration paid by the Group Entity, including employee expense-related taxes such as fringe benefit taxes. It also includes charges that have a direct connection with the benefits received by the person deriving the remuneration.

Eligible Personnel

1526. The term “eligible personnel” is relevant for determining *eligible payroll costs* of a Group Entity for a Period. There are two categories of *eligible personnel* which are described in subdivisions (i) and (ii).

1527. The first category, described in subdivision (i), provides that employees of the Group Entity are *eligible personnel*. Whether an individual is an “employee” is determined in accordance with the relevant employment or labour laws in the Jurisdiction where the Group Entity is located. The term covers all employees, regardless of whether they are full-time or part-time.

1528. The first category excludes a person described in subdivision (ii) with respect to another Group Entity of the same Covered Group. This exclusion applies in circumstances where an employee of the Group Entity is seconded to another Group Entity. In such circumstances, the employee would remain a formal employee of the Group Entity in question even though their activities are undertaken for another Group Entity. In this instance, salaries, wages, and other compensation paid by the employer entity would not be recognised as *eligible payroll costs* of the employer Group Entity because the individual would be recognised as *eligible personnel* in relation to the seconded Group Entity only and not the employer Group Entity that was responsible for paying such costs. This scenario is discussed further below.

1529. The second category of *eligible personnel*, described in subdivision (ii), refers to an individual that is not an employee of the Group Entity and that meets three conditions.

1530. First, the person should act under the “direction and control” of the Group Entity. “Direction” means that the person is required to perform their work in a certain way by, following the instructions, guidance, or advice as to how the work must be done issued by the Group Entity. The Group Entity will often co-ordinate how the work is done and at the time it is being undertaken.

1531. The person is acting under the “control” of the Group Entity if the Group Entity is able to dictate the work that person undertakes and the way in which the person goes about doing that work. Control includes circumstances where the Group Entity has the power to move the person from one job to another.

1532. With respect to interpreting whether “direction and control” exists in a given relationship between an individual and a Group Entity, a number of interpretive aspects should be considered. The existence of any one or more of the following characteristics will give rise to a rebuttable presumption that direction and control does indeed exist:

- personal performance of the individual is formally overseen by a person employed by the benefiting entity;

- costs of employment are subject to a cost-based (either at cost or cost plus) reimbursement by the benefiting entity to the contractual employer;
- benefiting entity is subject to pay-as-you-go (PAYG) withholding with respect to the individual in question.

1533. In order to demonstrate the existence or otherwise of direction and control over individuals who could potentially be identified as satisfying this criterion with respect to a Group Entity that is not the employing entity, Covered Groups should pay specific attention to individuals that are employees of a Group Entity and are either predominantly located in a Jurisdiction that is not the location of their employer or subject to a secondment agreement.

1534. Second, the person should predominantly participate in the ordinary operating activities of the Group Entity. This requires that the person contributes to the ordinary commercial activities of the Group Entity. The activities undertaken will usually be analogous to those that might otherwise be performed by an employee of the Group Entity.

1535. Third, the person should perform the relevant activities predominantly in the Jurisdiction in which the Group Entity or *taxable presence* to which the *entity payroll costs* or *taxable presence payroll costs* associated with their activity are attributed is located. The result is that the activity must be predominantly performed in the Jurisdiction where the *entity payroll costs* or *taxable presence payroll costs* are allocated for the purpose of calculating the Return on Depreciation and Payroll in a Jurisdiction in accordance with paragraph 1.

1536. Whether a person's relevant activities are performed "predominantly" in the location of the Group Entity or a *taxable presence* of the Group Entity. A person shall be considered to have predominantly performed their activities in a Jurisdiction if those activities are performed in that Jurisdiction for most of the Period. This would generally mean that more than 50% of their time is spent undertaking their activities in the Jurisdiction where the Group Entity or *taxable presence* is located.

1537. Subdivision (ii) caters for two scenarios. First, it applies to persons that are not employed by a Group Entity (and are therefore either employed by a third party, or are not employed at all and operating as a contractor under a contract for services) and that meet the conditions in clauses (A) through (C). This includes individuals that are directly engaged by the Group Entity as independent contractors as well as individuals that are employed by an independent contractor who is engaged by a Group Entity such that the individual formally employed by that independent contractor undertakes activities for the Group Entity and meets the conditions in clauses (A) through (C).

1538. Subdivision (ii) also caters for employees that are employed by one Group Entity but are seconded to another Group Entity. Subdivision (ii) requires that the person is not an employee of the Group Entity (i.e., the Group Entity to which the person is seconded), but the conditions in clauses (A) through (C) are all determined by reference to that Group Entity. A secondees will generally meet these conditions; they will not formally be employed by that Group Entity but will meet the conditions in clauses (A) through (C).

1539. Further, subdivision (i) does not apply to persons described in subdivision (ii). This means that, for the Group Entity described in the chapeau to subparagraph (m), the seconded employee will not be *eligible personnel* in accordance with subdivision (i). This prevents the person becoming *eligible personnel* for the Group Entity that is the formal employer and the Group Entity to which the person is seconded; the person will only ever be *eligible personnel* to one of those two Group Entities.

1540. There is a need to distinguish between situations where the person is seconded to a Group Entity and those whereby that person is performing services to one Group Entity on behalf of the Group Entity that employs that person under a contract for services between those two Group Entities. In this latter scenario, the conditions in clauses (A) and (B) are unlikely to be met. The person would be an employee of the Group Entity described in subdivision (i).

1541. For this purpose, a key consideration will be which enterprise bears the responsibility or risk for the results produced by the individual's work. If that risk is borne by the Group Entity that employs the person, then the relationship is unlikely to be a secondment and more likely to represent a contract for services. The conditions found in clauses (A) and (B) are unlikely to be met in such circumstances. The following factors may be relevant to determine whether the conditions in clauses (A) and (B) are met:

- who has the authority to instruct the individual regarding the manner in which the work has to be performed;
- who controls and has responsibility for the place at which the work is performed;
- the remuneration of the individual is directly charged by the formal employer to the Group Entity to which the services are provided;
- who puts the tools and materials necessary for the work at the individual's disposal;
- who determines the number and qualifications of the individuals performing the work;
- who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into with that individual for that purpose;
- who has the right to impose disciplinary sanctions related to the work of that individual; and
- who determines the holidays and work schedule of that individual.

1542. Where an individual who is formally an employee of one Group Entity provides services to another Group Entity, the financial arrangements made between the two Group Entities will clearly be relevant, although not necessarily conclusive, for the purpose of determining whether the remuneration of the individual is directly charged by the formal employer to the Group Entity to which the services are provided. For instance, if the fees charged by the Group Entity that formally employs the person represent the remuneration, employment benefits and other employment costs of that person for the services that he provided to the other Group Entity, with no profit element or with a profit element that is computed as a percentage of that remuneration, benefits and other employment costs, this would be indicative that the remuneration of the individual is directly charged by the formal employer to the Group Entity to which the services are provided. That should not be considered to be the case, however, if the fee charged for the services bears no relationship to the remuneration of the individual or if that remuneration is only one of many factors taken into account in the fee charged for what is really a contract for services (e.g. where a consulting firm charges a client on the basis of an hourly fee for the time spent by one of its employees to perform a particular contract and that fee takes account of the various costs of the enterprise). It is important to note, however, that the question of whether the remuneration of the individual is directly charged by the formal employer to the Group Entity to which the services are provided is only one of the subsidiary factors that are relevant in determining whether services rendered by that individual may properly be regarded as rendered in an employment relationship rather than as under a contract for services concluded between two Group Entities.

Paragraph 6

Entity Depreciation and Entity Payroll for an Incorporated Joint Venture

1543. Where an incorporated Joint Venture is subject to joint control by a Group Entity that incorporated Joint Venture is considered to be a Group Entity for purposes of this Annex B Section 5 (and for purposes of Article 12 and 13, and Annex B Section 4). Paragraph 6 contains rules that apply to define the *entity depreciation* and *entity payroll* for such an incorporated Joint Venture.

1544. Subparagraphs (a) through (c) describe the steps to be followed for this purpose. First, under subparagraph (a) the relevant *accounting depreciation* and *accounting payroll* shall be determined in accordance with the audited financial statements prepared for that incorporated Joint Venture under an Acceptable Financial Accounting Standard. Second, under subparagraph (b) adjustments described in paragraph 5(b) would be applied to convert the *accounting depreciation* figure for the incorporated Joint Venture to an *entity depreciation* figure that would be determined for that incorporated Joint Venture if was not subject to third party ownership interests and similar adjustments are applied under paragraph 5(j) to convert *accounting depreciation* to an *entity depreciation* figure that would be determined for that incorporated Joint Venture if was not subject to third party ownership interests (i.e., if it were wholly owned by the Covered Group). Finally, under subparagraph (c) adjustments would be applied to the figures determined under subparagraph (b) to apply a proportionate reduction to only recognise the relative proportion controlled by the Covered Group.

Section 6 – Withholding Tax Upward Adjustment

Paragraph 1

1545. Paragraph 1 provides the general definition of Withholding Tax Upward Adjustment for the purpose of calculating the *adjusted elimination profit (or loss)* under Article 5(2)(f), which feeds into Article 5(2)(c)(ii) for the purpose of calculating *adjusted jurisdictional excess profits* considered in the *marketing and distribution profits safe harbour adjustment*. This adjustment thus typically increases the relevant measure of jurisdictional profits for purposes of the *marketing and distribution profits safe harbour adjustment* in the Jurisdiction where the Covered Withholding Tax is imposed (typically the Jurisdiction where the payor is located).

1546. Withholding Tax Upward Adjustments apply only with respect to Covered Withholding Taxes imposed with respect to Covered Payments. These terms are defined in Article 2(j) and (k).

1547. Where a Covered Payment is made from Group Entity A in Jurisdiction A to Group Entity B in Jurisdiction B and the tax authority in Jurisdiction A imposes a Covered Withholding Tax on the Covered Payment, a *withholding tax upward adjustment* will be recognised in the *adjusted elimination profit (or loss)* of the Covered Group in Jurisdiction A. The same applies to a Covered Payment made by a third party to Group Entity B that is subject to a Covered Withholding Tax in Jurisdiction A.

1548. Paragraph 1 provides that the Withholding Tax Upward Adjustment for a Covered Group for a Period in a Jurisdiction is the sum of two elements. First, subparagraph (a) provides for the inclusion of an amount equal to the *current withholding tax upward adjustment* determined under paragraph 2 with respect to each Covered Payment in the Period that is subject to a Covered Withholding Tax. Second, subparagraph (b) provides for the inclusion of *withholding tax upward spreading adjustments* in the Period with respect to each Covered Payment during prior Periods that were subject to a Covered Withholding

Tax. How *withholding tax upward spreading adjustments* should be included is determined using paragraph 3.

Paragraph 2

1549. The *current withholding tax upward adjustment* for the Covered Group with respect to a Covered Payment subject to a Covered Withholding Tax in the Period is calculated in accordance with paragraph 2 and is equal to the product determined by multiplying the amount provided in subparagraph (a) by the number provided in subparagraph (b).

1550. The amount described in subparagraph (a) is the *withholding tax upward amount* with respect to a Covered Payment in the Period calculated with reference to the relevant *tax liability determination* in the Jurisdiction imposing the Covered Withholding Tax on that Covered Payment made in the Period. The definition of Covered Payment is included in Article 2(j) and includes income arising in a Jurisdiction and paid to a Group Entity of a Covered Group located in another Jurisdiction subject to defined exclusions. The relevant *tax liability determination* is the most recent *tax liability determination* for that Covered Payment in the Jurisdiction that imposed the Covered Withholding Tax at least 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period. The term *tax liability determination* is defined in Annex B Section 4(13)(g). In most instances, the applicable *tax liability determination* would be the original withholding tax collected by the payor of the Covered Payment (a Group Entity or third party) and remitted to the tax authorities with a self-assessed withholding tax filing. However, in some instances, it is possible that an amended self-assessed withholding tax filing could be filed prior to 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period and in that case that subsequent filing would be the applicable *tax liability determination* for the Period. In limited cases a withholding tax liability assessment could be raised by a tax administration 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period and in that case that withholding tax liability assessment may be the applicable *tax liability determination* for the Period. If no withholding tax filing *has been* made for the Group Entity or third party that made a Covered Payment to the Group Entity that is subject to a Covered Withholding Tax 60 days before the deadline for filing the Covered Group's Amount A Tax Return and Common Documentation Package for the Period, there will be no adjustment in that Period with respect to the Covered Payment and the *current withholding tax upward adjustment* will be zero.

1551. For purposes of assessing whether a *tax liability determination* exists in relation to a *withholding tax upward amount*, only determinations in the Jurisdiction where the Covered Withholding Tax is imposed are relevant. In some instances the *tax liability determination* will be made by a third-party payer of a Covered Payment.

1552. The amount described in subparagraph (b) is 100 per cent less the *withholding tax upward adjustment reduction factor*, as defined in paragraphs 4 and 5. The applicable *withholding tax upward adjustment reduction factor* is the one that was applicable to the Covered Group in the Period when the Covered Payment was made.

Paragraph 3

1553. Paragraph 3 provides for an amount to be included in the Withholding Tax Upward Adjustment in a Period and subsequent Periods if, as of the end of the current Period, the most recent *tax liability determination* in the Jurisdiction imposing the Covered Withholding Tax with respect to a Covered Payment in a prior Period in which the Group was a Covered Group, or a previously unrecognised Covered Payment in a prior Period in which the Group was a Covered Group, would result in a change in the *withholding tax*

upward amount for that Covered Payment. Paragraph 3 intends to provide a mechanism to enable the spreading of adjustments that would be recognised in a Period other than the Period that the relevant Covered Payment took place. In this way the relevant provisions are similar to the mechanism provided with respect to *taxable presence elimination profit or loss* (Annex B Section 4(3)), *profit allocation adjustment* (Annex B Section 4(7)), and *main entity taxable presence adjustment* (Annex B Section 4(11)), *withholding tax downward adjustment* (Annex B Section 4(12)) respectively).

1554. In most cases, a *withholding tax upward spreading adjustment* will increase the *adjusted elimination profit (or loss)* at Article 5(2)(f) with respect to the Jurisdiction where the adjustment is applied. However, in some limited cases the reverse may be observed. This would occur where a *tax liability determination* with respect to a Covered Withholding Tax results in a reduction in the *withholding tax upward amount* with respect to a Covered Payment. For example, consider a scenario where an initial self-assessed withholding tax filing relating to a Covered Payment in 2028 resulted in a *withholding tax upward amount* of EUR 1 million in 2028, then a tax administration assessment increase the *withholding tax upward amount* to EUR 2 million in 2029 and then a court decision reduced that *withholding tax upward amount* back to EUR 1 million in 2030. In this case, the *withholding tax upward amount* would reduce by EUR 1 million in 2030 and this reduction would be taken into account as a negative *withholding tax upward spreading adjustment* in 2030 that would reduce *adjusted elimination profit (or loss)* in 2030.

1555. Paragraph 3 requires that an amount will only be recognised in the Period if at least 75 per cent of the additional tax liability or tax refund associated with the applicable *tax liability determination* is paid before the end of that Period.

1556. Where the taxpayer or tax administration has made no or insufficient payment following a *tax liability determination*, including in cases where it has lodged an appeal against the tax assessment or initiated compliance proceedings, the entire amount of the change in *withholding tax upward amount* will not (yet) be taken into account for the purpose of calculating the *withholding tax upward amount* and accordingly determining the *adjusted elimination profit (or loss)*. Once at least 75 per cent of the additional tax or refund amount is paid in aggregate, for example in a case where the taxpayer decides to accept the tax assessment or loses the appeal and is compelled to make payment, the change in *withholding tax upward amount* from the *tax liability determination* must be recognised in that Period. A *tax liability determination* relating to a Covered Withholding Tax can therefore only create a potential reduction in Amount A allocations in a Jurisdiction in the context of the *marketing and distribution safe harbour adjustment* where at least 75 per cent of the additional tax is paid or at least 75 per cent of the refund is paid.

Box 29. Example –Withholding Tax Upward Adjustments

- For example, the Amount A Tax Return and Common Documentation Package for the year ended 31 December 2029 was due on 31 December 2030. A Covered Withholding Tax amounting to EUR 1 000 was assessed in Jurisdiction A on 30 September 2030 (as a result of the payer realising it had not adequately withheld on a prior transaction and making a self-assessment) relating to a Covered Payment paid to a Group Entity in Jurisdiction B during 2029, the amount withheld would be taken into account to determine a “current withholding tax upward adjustment” in Jurisdiction A for the 2029 Amount A Tax Return and Common Documentation Package filing by virtue of paragraph 2(a). The *withholding tax upward amount* in this instance would be equal to EUR 1 000 divided by rate of income tax imposed by Jurisdiction A in the Period on amounts allocated to it under Article 5 and the *current withholding tax upward adjustment* would equal this *withholding tax upward amount*, multiplied by 100 per

cent less the applicable *withholding tax upward adjustment reduction factor* (refer to paragraph 1574).

- If, in 2032, the tax authority of Jurisdiction A increased the amount of tax withheld by EUR 3 000 with respect to that Covered Payment in 2029 (so that the total Covered Withholding Tax relating to the Covered Payment in Jurisdiction A in 2029 was EUR 4 000), additional tax would be due in Jurisdiction A and an increase in *withholding tax upward amount* would be determined. However, if the Covered Group did not make any payment in respect of that assessment during 2032, there would be no *withholding tax upward spreading adjustment* with respect to the Covered Payment relating to 2029 Period that would be recognised in the 2032 Period.
- Similarly, if the Covered Group made payment of EUR 100 with respect to the EUR 3 000 assessment during 2032, no *withholding tax upward spreading adjustment* would be made with respect to the Covered Payment in the 2032 Amount A Tax Return and Common Documentation Package with respect to the EUR 3 000 assessment since the tax payment did not represent at least 75 per cent of the additional tax assessed.
- However, if during 2032, the Covered Group paid EUR 2 500 in respect of the EUR 3 000 assessment, the 75 per cent threshold would be met, and the Covered Group would be required to recognise a *withholding tax upward spreading adjustment* relating to the change in *withholding tax upward amount* of the Covered Payment for the 2029 Period with respect to the amount of EUR 3 000. The *withholding tax upward amount* in this instance would be equal to EUR 3 000 divided by the applicable income tax rate, and the *withholding tax upward spreading adjustment* would be determined based on that amount.
- If in circumstances where the Covered Group made the payment of EUR 2 500, the taxpayer appealed the increased assessment and in 2033 the courts of Jurisdiction A determined that the total withholding tax liability for the Covered Payment for 2029 should have been EUR 3 000, a change in the *withholding tax upward amount* of EUR 1 000 relating to the Covered Payment for 2029 would again be observed and a *withholding tax upward spreading adjustment* would be observed provided that 75 per cent payment requirement is satisfied. In determining whether the tax authority had paid 75 per cent of the refund in this case both the outstanding amount owed by the taxpayer in relation to the prior *tax liability determination* and any payment by the tax administration would be taken into account. In this case, EUR 500 was already outstanding so provided that at least EUR 250 is paid from the tax administration to the taxpayer before the end of 2033 that change should be recognised in the Amount A Tax Return and Common Documentation Package for 2033.

1557. It should also be noted that the *withholding tax upward amount* refers to Covered Withholding Taxes only. It does not include additional amounts paid by a Group Entity or third party, such as penalties or interest. This is discussed further at paragraph 1186 of this Explanatory Statement.

1558. Where the above described conditions with respect to paragraph 3 are satisfied (i.e., a *tax liability determination* is made in respect of a Covered Payment that changes the *withholding tax upward amount* recognised in a prior Period or establishes a *withholding tax upward amount* with respect to a Covered Payment in a prior Period not previously recognised and at least 75 per cent of the additional tax or refund resulting from the *tax liability determination* is paid), the *withholding tax upward amount* resulting from the *tax liability determination* will be taken into account in determining a *withholding tax upward spreading adjustment* that may be subject to spreading over multiple future Periods.

1559. Subparagraph (a) provides that the amount of the *withholding tax upward spreading adjustment* will be equal to the product of (i) multiplied by (ii). (i) equals the amount of the change in *withholding tax upward amount* (refer to discussion of this separate defined term from paragraph 1574). (ii) equals 100 per cent less the *withholding tax upward adjustment reduction factor* (refer to paragraph 1577). This *withholding tax upward spreading adjustment* is recognised over one or more Periods. Applicable spreading is determined in one of three ways depending on the circumstances of the change, as clarified in subparagraph (b).

1560. Subparagraph (b)(i) provides that if the change in the *withholding tax upward amount* is less than EUR 5 million, the entire adjustment (i.e., the change in *withholding tax upward amount* after applying the *withholding tax upward adjustment reduction factor*) shall be taken into account in the current Period. This outcome will apply regardless of whether *withholding tax upward spreading adjustments* relating to that Covered Payment are still being recognised in the current Period from a *tax liability determination* in a prior Period which might apply where a prior change in *withholding tax upward amount* in excess of EUR 5 million that is subject to spreading under subparagraph (b) occurred in the previous Period whereas the current change is less than EUR 5 million.

1561. Subparagraph (b)(ii) provides that if the change in the *withholding tax upward amount* is at least EUR 5 million, the entire adjustment (i.e., the change in *withholding tax upward amount* after applying the *withholding tax upward adjustment haircut*) shall be taken into account partially in the current Period and partially in future periods.

1562. Subparagraph (b)(ii)(A) applies in cases where there has been a previous adjustment under paragraph 3 in the same Jurisdiction in respect of the same Covered Payment and where all of the *withholding tax upward spreading adjustments* have not yet been taken into account. In that case, the new adjustment (i.e., the change in *withholding tax upward amount* after applying the *withholding tax upward adjustment reduction factor*) is combined with the remaining adjustment in respect of the prior Period that has not yet been included in determining the *adjusted elimination profit (or loss)* for any Period. The net amount is spread equally over Periods beginning with the current Period and consisting of the greater of:

- Three Periods;
- the number of Periods to which the determination giving rise to the current change relates; and
- the number of Periods over which the remaining *withholding tax upward spreading adjustment* from the prior change are spread.

1563. For example, if an assessment was made in Jurisdiction A in 2028 that resulted in a total *withholding tax upward spreading adjustment* (i.e., the change in *withholding tax upward amount* after applying the *withholding tax upward adjustment reduction factor*) of EUR 120 million in respect of a Covered Payment during the 2026 tax year, the *withholding tax upward spreading adjustment* would be made over three Periods as the adjustment relates to a single tax year and the EUR 5 million materiality threshold is satisfied. Assuming at least 75 per cent of the additional tax was paid in 2028, an adjustment of EUR 40 million would be made in each of the three Periods commencing from 2028. If, two years later in 2030, a subsequent amendment to the original assessment was made resulting in a new *withholding tax upward spreading adjustment* (i.e., the change in *withholding tax upward amount* after applying the *withholding tax upward adjustment reduction factor*) that reduced the *withholding tax upward amount* by EUR 10 million in respect of the same Covered Payment during the 2026 tax year, clause (A) would apply. The net adjustment would be EUR 30 million (i.e., the remaining amount in respect of the prior adjustment would be EUR 40 million (EUR 120 million less two years of spreading adjustments recognised in 2028 and 2029) less the EUR 10 million change to the *withholding tax upward amount*) which would be required

to be spread equally across three Periods. Three is the minimum number of Periods over which a *withholding tax upward spreading adjustment* may be spread under clause (A). That is greater than the number of Periods to which the 2030 adjustment relates and the number of remaining Periods over which the remainder of the 2028 adjustment will be made (in both cases, one Period).

1564. For purposes of applying the rules in paragraph 3, the number of Periods to which the determination giving rise to the current change relates should be interpreted having regard to the Explanatory Statement with regard to the definition of *tax liability determination* (see paragraph 1465).

1565. Commonly the number of Periods impacted by both the current change in *withholding tax upward amount* and the previously recognised *withholding tax upward amount* that has not yet been fully recognised will be the same. This might be because the second change relates to a challenge to an original tax assessment and the scope of both determinations is the same. Where this is the case, the re-setting of the applicable spreading period will result in a prolonging of the number of Periods over which the original adjustment is recognised.

1566. If a *tax liability determination* was made by Jurisdiction A in 2034 resulting in a total *withholding tax upward spreading adjustment* (i.e., the change in *withholding tax upward amount* after applying the *withholding tax upward adjustment reduction factor*) of EUR 120 million in respect of a Covered Payment made by Group Co A in Jurisdiction A to Group Co B in Jurisdiction B in respect of the 2027 to 2032 tax years, the *withholding tax upward spreading adjustment* would be made over six Periods as the adjustment relates to six tax years. Assuming at least 75 per cent of the additional tax was paid in 2034, an adjustment of EUR 20 million would be made to increase the *adjusted elimination profit (or loss)* of the Covered Group in Jurisdiction A in each of the six Periods commencing from 2034. If, two years later in 2036, a subsequent *tax liability determination* resulting in downward total *withholding tax upward spreading adjustment* (i.e., the change in *withholding tax upward amount* after applying the *withholding tax upward adjustment reduction factor*) of EUR 20 million was made by Jurisdiction A in respect of the same transaction and the 2027 to 2032 tax years, subclause (A) would apply assuming at least 75 per cent of the tax refund was paid. The net adjustment would be EUR 60 million (i.e., the remaining amount in respect of the prior adjustment would be EUR 80 million (EUR 120 million less two years of spreading adjustments recognised in 2034 and 2035) less the new EUR 20 million upward adjustment) which would be required to be spread equally across six Periods. Six is the number of Periods to which the determination giving rise to the 2036 change relates (2027-2032). That is greater than the default three Periods and the number of Periods remaining for the 2034 adjustment (four Periods, assuming the refund is paid in 2036)).

1567. Subparagraph (b)(ii)(B) applies in all other cases that are not covered by clause (A) where the change in the *withholding tax upward amount* is greater than EUR 5 million. That would be the case if, for example, there has been no previous *withholding tax upward amount* in respect of the same Covered Payment, or there has been such an amount recognised, but the full amount of that prior adjustment has already been taken into account. In those cases, the adjustment is spread equally across a term beginning with the current Period and consisting of the greater of three Periods; and the number of Periods to which the determination giving rise to a change in the *profit allocation amount* relates.

1568. For example, if a *tax liability determination* resulting in a total *withholding tax upward spreading adjustment* (i.e., the change in *withholding tax upward amount* after applying the *withholding tax upward adjustment reduction factor*) of EUR 120 million was made by Jurisdiction A in 2030 in respect of a Covered Payment arising in 2028, that adjustment should be treated as a *withholding tax upward spreading adjustment* under paragraph 3. Assuming that the *tax liability determination* was the first *tax liability determination* in respect of that *Covered Payment* after the period that the transaction occurred, clause (B) would require that the *withholding tax upward spreading adjustment* of EUR 120 million (which would increase *adjusted elimination profit (or loss)* in this case) be included in the *adjusted elimination profit (or*

loss) of Jurisdiction A. The inclusion would be required to be spread equally across three Periods because the adjustment relates to a single Period (2028). Accordingly, an adjustment of EUR 40 million would be included in the *adjusted elimination profit (or loss)* of Jurisdiction A for each Period commencing in 2030, assuming at least 75 per cent of the tax would be paid in that year.

Paragraph 4

1569. Paragraph 4 is designed to deal with cases where a Covered Group comes in and out of scope of Amount A. It is intended to ensure that *tax liability determinations* with respect to Covered Payments that occurred when the Group was in scope of Amount A that are made during Periods when the Group is not in-scope of Amount A are taken into account when the Group subsequently comes back into scope of Amount A in specified cases. The provision will not apply if the most recent change in *withholding tax upward amount* prior to the current Period with respect to a Covered Payment occurred more than two Periods before the Group comes back into scope.

1570. With respect to a Covered Payment in a prior Period, a change in the *withholding tax upward amount* will be recognised in respect of that Covered Payment in the Period where conditions in subparagraphs (a) and (b) are satisfied.

1571. The first condition is that the Group was not a Covered Group in the immediately preceding Period. The second condition is that the most recent change in *withholding tax upward amount* prior to the Period with respect to the Covered Payment resulted from a *tax liability determination* during a Period when the Group was not a Covered Group and less than two years before the beginning of the Period. In those cases, the *withholding tax upward amount* in the Period will be deemed equal to the relevant *withholding tax upward amount* in the latest *tax liability determination* in the Jurisdiction that imposed the Covered Withholding Tax in respect of the Covered Payment prior to the end of the current Period, less the relevant *withholding tax upward amount* determined by the latest *tax liability determination* in the Jurisdiction that imposed the Covered Withholding Tax with respect to that Covered Payment during a prior Period where the Group was a Covered Group.

1572. For example, a Group that was in-scope of Amount A in 2024 recognised a Covered Payment in Jurisdiction A resulting in a *withholding tax upward amount* of EUR 100 million in 2024. The Group fell out of scope of Amount A in 2025. In 2030, the tax authority in Jurisdiction A issued an assessment that increased the *withholding tax upward amount* by EUR 30 million with respect to the Covered Payment made in 2024. If the Group came back into scope of Amount A in 2031 (less than two Periods after the prior change in *withholding tax upward amount* took place) the Covered Group would recognise an increase in the *withholding tax upward amount* in Jurisdiction A of EUR 30 million (assuming that at least 75% of the additional tax was paid). This adjustment would be subject to spreading treatment as described above commencing from 2031.

1573. There could conceptually be situations where both paragraphs 3 and 4 apply in a given Period. For instance, such situations could happen if a Group Entity, located in Jurisdiction A made a Covered Payment to a Group Entity in Jurisdiction B in 2023 when the Group was a Covered Group. Further, the Group fell out of scope and was not a Covered Group in 2027 but returned to become a Covered Group in 2028, and Jurisdiction A increased the amount of withholding tax withheld with respect to that 2023 Covered Payment as a result of a *tax liability determination* made in 2027 and then reduced the assessment in 2028 under two separate *tax liability determinations*. In such a case, the net amount of the two changes in the *withholding tax upward amount* from paragraphs 3 and 4 will be taken into consideration. For example, if the *tax liability determination* in 2027 led to increase in *withholding tax upward amount* of EUR 50 million and the 2028 determination led to a decrease of in *withholding tax*

upward amount of EUR 30 million, then the net increase of EUR 20 million will be considered as the change in *withholding tax upward amount* for the purpose of applying paragraphs 3 and 4 simultaneously for 2028.

Paragraph 5

1574. Paragraph 5 provides the general definition of “withholding tax upward amount” for purposes of calculating the Withholding Tax Upward Adjustment under paragraph 1 which feeds into the *marketing and distribution safe harbour adjustment* in Article 5(2)(a).

1575. The “withholding tax upward amount” is calculated with respect to a Covered Payment by dividing the Covered Withholding Tax (i.e., a tax amount) as per the applicable *tax liability determination* in the Jurisdiction where the Covered Withholding Tax is imposed by the rate of income tax imposed on amounts allocated to that same Jurisdiction under Article 5. For instance, if the amount of the Covered Withholding Tax is EUR 5 million according to a relevant *tax liability determination*, and the rate of income tax imposed by that Jurisdiction on Amount A profit allocated under the Convention in the Period is 25 per cent, then the *withholding tax upward amount* would be EUR 20 million (= EUR 5 million / 25%). This calculation is effectively converting the amount of the Covered Withholding Tax (i.e., a tax amount) into a profit equivalent amount of that tax for purposes of the *marketing and distribution safe harbour adjustment* under Article 5(2). Consistent with Article 20(1), the rate used in this calculation cannot exceed the rate that would have been imposed in accordance with the income tax regime generally applicable in the Jurisdiction on business profits of an enterprise carried on by a body corporate with the same relevant characteristics.

1576. For purposes of determining the *withholding tax upward amount*, only *tax liability determinations* that determine the quantum of withholding tax liability in the Jurisdiction imposing the Covered Withholding Tax are relevant.

Paragraph 6

1577. Paragraph 6) provides the general definition of “withholding tax upward adjustment reduction factor” for purposes of calculating the “Withholding Tax Upward Adjustment” under paragraph 1 which feeds into the *marketing and distribution safe harbour adjustment* in Article 5(2).

1578. The *withholding tax upward adjustment reduction factor* that applies for purposes of calculating the Withholding Tax Upward Adjustment differs depending on the level of depreciation and payroll of the Covered Group in the Jurisdiction where the Covered Withholding Tax is imposed. Under subparagraphs (a) through (c) a Jurisdiction that imposes a Covered Withholding Tax in a Period will be categorised based on Jurisdictional Depreciation and Payroll defined in Annex B Section 5(3) of a Covered Group for a Period in that Jurisdiction, similar to the threshold used to determine *jurisdictional offset percentage* under Article 5(2)(d).

1579. First, subparagraph (a) provides that the *withholding tax upward adjustment reduction factor* will be 60 per cent for a *low depreciation and payroll jurisdiction* defined in Article 5(2)(e), in instances where two conditions are satisfied. The first condition contained in subdivision (i) is that the *jurisdictional depreciation and payroll* of a Covered Group for a Period in the Jurisdiction is less than EUR 50,000. The second condition in relation to subdivision (i) is that no Group Entity of the Covered Group is located in the Jurisdiction that has Entity Financial Third-party Accounting Revenues in the Period. Second, subparagraph (b) provides that the *withholding tax upward adjustment reduction factor* will be 30 per cent for all *low depreciation and payroll jurisdictions* that do not satisfy subparagraph (a). Third, paragraph 3 provides that the *withholding tax upward adjustment reduction factor* will be 15 per cent in all other cases. Examples of determining whether a Jurisdiction is a *low depreciation and payroll jurisdiction* can be found in paragraphs 223 and 224.

1580. The tailing clause of paragraph 6 provides the *withholding tax upward adjustment reduction factors* for Jurisdictions that are Lower Income Jurisdictions, as defined in Article 2. For those Jurisdictions, the *withholding tax upward adjustment reduction factor* will be 70 per cent where the conditions of subparagraph (a) are satisfied and 40 per cent where the conditions of subparagraph (b) are satisfied. The 15 per cent *withholding tax upward adjustment reduction factor* provided in subparagraph (c) would remain at 15 per cent regardless of whether the Jurisdiction is a Lower Income Jurisdiction.

Paragraph 7

1581. Paragraph 7 provides rules for calculating the *withholding tax upward adjustment reduction factor* that will apply instead of the rules in paragraph 6 during a “transitional period”. Broadly, the calculation of the *withholding tax upward amount* would remain the same during the transitional period for withholding taxes, but the applicable *withholding tax upward adjustment reduction factors* will differ.

1582. First, subparagraph (a) provides that the *withholding tax upward adjustment reduction factor* will be 100 per cent in the first two Periods of the Covered Group to which the Convention applies in accordance with Article 49 (in cases where the first Period is a straddling period under Article 49(3)(a)(iii) and less than 183 days of that Period fall after the date of entry into effect, *withholding tax upward adjustment reduction factor* will in practise be 100 per cent for this straddling Period in addition to the following two Periods). Applying the 100 per cent *withholding tax upward adjustment reduction factor* effectively means that a Withholding Tax Upward Adjustment shall not practically apply with respect to Covered Payments in the first two years after the Convention enters into effect for all Covered Groups that are in-scope during their first two Periods following that date (i.e., the first stage of the transitional period).

1583. Second, subparagraph (b) provides that the *withholding tax upward adjustment reduction factor* will be 75 per cent for each Period that begins after the two Periods referenced in subparagraph (a) and ends before the first Period for which Article 3(9) applies, in cases indicated in subdivisions (i) and (ii). This means the *withholding tax upward adjustment reduction factor* of 75 per cent will apply to those Jurisdictions that satisfy subdivision (i) or (ii) in Periods following the first two Periods of a Covered Group after the entry into effect of the Convention, until the scope threshold for Amount A (i.e., Adjusted Revenues greater than EUR 20 billion under Article 3(a)) is lowered to EUR 10 billion pursuant to Article 3(9), after the 7-year review of Amount A implementation under Article 43. During this second stage of the transitional period, a 75 per cent *withholding tax upward adjustment reduction factor* will apply to two groups of Jurisdictions that meet the following criteria: the Jurisdictions that meet the two conditions included in paragraph 6(a) or *low depreciation and payroll jurisdictions* defined in Article 5(2)(e).

1584. Third, subparagraph (c) provides that the *withholding tax upward adjustment reduction factor* will be 50 per cent during the second stage of transitional period, for each Period that begins after the two Periods of a Covered Group described in subparagraph (a) and ends before the first Period for which Article 3(9) applies, for Jurisdictions that do not satisfy the conditions in subparagraph (a) or (b).

1585. To summarise, the relevant *withholding tax upward adjustment reduction factor* applicable for purposes of calculating the Withholding Tax Upward Adjustment will be:

Jurisdiction Type	Transitional Rules (paragraph 7)		Normal Rules (paragraph 6)	
	First two Periods	Third year and until lowering of revenue threshold	Lower Income Jurisdictions	Other jurisdictions
Low depreciation and payroll jurisdictions with jurisdictional depreciation and payroll less than EUR 50 000 and no Group	100% (paragraph 7(a))	75% (paragraph 7(b))	70% (last sentence of paragraph 6)	60% (paragraph 6(a))

Entity located in that Jurisdiction that has <i>Entity Financial Third-party Accounting Revenues</i> in the Period				
Low depreciation and payroll jurisdictions that do not satisfy paragraph 6(a)			40% (last sentence of paragraph 6)	30% (paragraph 6(b))
Others		50% (paragraph 7(c))	15% (paragraph 6(c))	

Annex C – Supplementary provisions for Article 3

Section 1 – Provisions for group mergers and demergers, internal fragmentation, dual-listed arrangements and stapled structures

Group mergers and demergers

1586. Annex C Section 1(1) provides an exception to the general operation of the tests contained in Article 3(2), where a particular type of business reorganisation is undertaken in the Period or any of the five Periods immediately preceding the Period. It only applies in limited prescribed circumstances where:

- a *group merger* occurs, as defined in Annex C Section 1(2)(e); or
- a *group demerger* occurs, as defined in Annex C Section 1(2)(d).

1587. In all other instances of a business reorganisation the provisions of Article 3(2) continue to apply. As addressed in the section of this Explanatory Statement that relates to Article 3(2), in the case of business combinations that do not meet the definition of *group merger* and *group demerger* the approach is to use the Consolidated Financial Statements of the Ultimate Parent Entity, which provides the relevant consolidated financial data across the four Periods immediately preceding the Period. In contrast, in the case of a *group merger* or *group demerger*, the Consolidated Financial Statements of the Ultimate Parent Entity of the Group (or Groups) that exists after the business reorganisation does not provide the relevant consolidated financial data for the calculation of the *pre-tax profit margin* for the Periods prior to the business reorganisation for purposes of Article 3(2). Paragraph 1 therefore applies in these cases to modify the application of the *pre-tax profit margin* calculation for purposes of Article 3(2) where a *group merger* or *group demerger* occurs in any of the five Periods immediately preceding the Period, such that the calculation applies to consolidated financial data that is available. Where a *group merger* or *group demerger* occurred in the Period prior to the five Periods immediately preceding the Period, paragraph 1 will not apply as the Consolidated Financial Statements of the Ultimate Parent Entity will reflect the position of the Group post-*group merger* or post-*group demerger*, as the case may be, and there is no requirement to examine the *pre-tax profit margin* the Group in any earlier Period.

1588. In the case of a *group merger*, paragraph 1(a) applies so that the calculation of *pre-tax profit margin* is amended so that the reference to “Group” is replaced with *acquiring group* (or with *existing group* where there is no *acquiring group*). The latter term is defined in Section 1(2)(a) and based on the concept of identifying the acquirer for purposes of an Acceptable Financial Accounting Standard (see the relevant section of this Explanatory Statement below). The effect of this is the *pre-tax profit margin*, Adjusted Profit Before Tax, and Adjusted Revenues are calculated using the Consolidated Financial Statements of the *acquiring group* in the Period(s) prior to the *merger period*. The *pre-tax profit margin* and Adjusted Profit Before Tax of the Group in the *merger period* and the Periods that follow the *merger period* are not affected by paragraph 1(a) and the calculation is based on the Consolidated Financial Statements of the Ultimate Parent Entity.

1589. In the case of *group demerger*, paragraph 1(b) applies so that the calculation of the *pre-tax profit margin* and Adjusted Profit Before Tax are amended so that the reference to “Group” is replaced with *demerging group*. The latter term is defined in Section 1(2)(d) which also provides the definition of *group demerger* and *demerged group*. The effect of this is that the *pre-tax profit margin* and Adjusted Profit Before Tax is calculated using the Consolidated Financial Statements of the *demerging group*, in the Period(s)

prior to the *demerger period*. The *pre-tax profit margin* and Adjusted Profit Before Tax of the Group in the *demerger period* and the Periods that follow the *demerger period* are not affected by paragraph 1(b) and the calculation is based on the Consolidated Financial Statements of the Ultimate Parent Entity.

Acquiring group

1590. Annex C Section 1(2)(a) provides the definition of an *acquiring group* for purposes of the Convention. The term *acquiring group* is relevant where an arrangement is undertaken that meets the definition of *group merger* in paragraph 2(e). In such cases, paragraph 1 specifies that:

- the *acquiring group's* Consolidated Financial Statements should be used for the purpose of calculating the *pre-tax profit margin* and Adjusted Profit Before Tax for the Periods prior to the *group merger*; and
- the Adjusted Revenues of the *acquiring group* should be used for purposes of the calculation in Article 3(2)(b) for the Periods prior to the *group merger*.

1591. Paragraph 2 provides that in the case of a *group merger* the *acquiring group* means the Group that existed and included the combining Entity that is the acquirer prior to the *group merger* for purposes of an Acceptable Financial Accounting Standard (the use of “for purposes of” means that this term includes cases where the combining Entity is identified by relevant domestic law provisions which are then followed for the purposes of the relevant Acceptable Financial Accounting Standard). The definition of the *acquiring group* therefore relies on the identification of the acquirer for purposes of an Acceptable Financial Accounting Standard.

1592. Where a business combination occurs for purposes of an Acceptable Financial Accounting Standard, it is necessary to identify the acquirer under the acquisition method. The acquirer is generally the Entity that gains control of the acquiree and this concept is central to the requirement to prepare Consolidated Financial Statements and the presentation of those statements.

1593. In some cases, a business combination may occur but it may not be possible to clearly identify the Entity that gains control. It may be the case that a business combination that meets the definition of *group merger* falls into this category. However, in such cases the requirement to identify the acquirer for purposes of an Acceptable Financial Accounting Standard is not extinguished. Instead, various factors are provided that should be considered in making the determination of the Entity that is the acquirer and these factors look to the substance of the business combination, rather than solely relying on its legal form. Notably, a new entity formed to effect a business combination is not necessarily the acquirer.

1594. For example, under IFRS 3 Business Combinations (See IFRS 3 Business Combinations - Appendix B: Application guidance), factors that include the following are considered in determining the acquirer:

- where a business combination is effected by primarily transferring cash, other assets, or by incurring liabilities, the acquirer is usually the entity that transfers cash, other assets, or incurs the liabilities;
- where a business combination is effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests;
- the relative voting rights in the combined entity after the business combination;

- the existence of a large minority voting interest in the combined entity if no owner or organised group of owners has a significant voting interest;
- the composition of the governing body of the combined entity;
- the composition of the senior management of the combined entity;
- the terms of the exchange of the equity interests;
- the relative size of the combining entities;
- the combining entity that initiated the business combination where there are more than two entities.

1595. This list of factors under IFRS 3 Business Combinations is illustrative and is not exhaustive. Further, the list should not be interpreted as modifying or affecting the application of the Acceptable Financial Accounting Standard for purposes of the Convention. The definition of the *acquiring group* follows the identification of the acquirer for purposes of the relevant Acceptable Financial Accounting Standard (or relevant domestic law provisions, see also paragraph 1591 of this Explanatory Statement).

1596. Generally, the factors that should be considered where it is not possible to clearly identify the Entity that gains control are largely consistent across different Acceptable Financial Accounting Standards.

Demerger period

1597. A Period is a *demerger period* if the *group demerger* occurs in that Period.

Existing group

1598. An *existing group* is the Group (other than an *acquiring group*) that existed prior to a *group merger* and that produced Consolidated Financial Statements.

Group demerger

1599. A *group demerger* is any transaction or arrangement that results in a single Group being separated into two or more Groups. After the demerger of a single Group (the *demerging group*), its Group Entities will no longer be consolidated on a line-by-line basis by the same Ultimate Parent Entity but continue to be consolidated on a line-by-line basis by two or more Ultimate Parent Entities of different Groups (each a “demerged group”) from the date of the demerger.

1600. This definition relies on the consolidation test and the definition of a Group included in Article 2. Therefore, whether a Group is separated into two or more Groups depends on whether each separated collection of Entities meets the definition of a Group and has its own Consolidated Financial Statements.

Group merger

1601. The definition of a *group merger* is important for two main reasons:

- First, where a business reorganisation meets the definition of a *group merger*, the application of the profitability test is amended under Annex C Section 1(1) for the purpose of applying Article 3(2). Specifically, the calculation of the *pre-tax profit margin* and Adjusted Profit Before Tax for the Period(s) prior to the merger is performed using the Consolidated Financial Statements of the *acquiring group* (or *existing group* where there is no *acquiring group*).

- Secondly, where a business reorganisation meets the definition of a *group merger*, the calculation in Article 3(2)(b) is modified such that reference to Adjusted Revenues in the weighted average calculation is changed to Adjusted Revenues of the *acquiring group* (or *existing group* where there is no *acquiring group*) for the Periods prior to the *merger period*.

1602. The definition of *group merger* contains two parts. The first part provides that an arrangement or transaction is undertaken that represents a business combination for purposes of an Acceptable Financial Accounting Standard. The term “business combination” is commonly used across different Acceptable Financial Accounting Standards (or relevant domestic law provisions, see also paragraph 1602 of this Explanatory Statement) and is a broad term that includes a transaction or other event in which an acquirer obtains control of one or more businesses (For example, IFRS 3 Business Combinations – Appendix A Defined Terms provides a business combination is “[a] transaction or other event in which an acquirer obtains control of one or more businesses”). This includes, but is not limited to, transactions sometimes colloquially referred to as “true mergers” or “mergers of equals”. Where an arrangement does not constitute a business combination for purposes of an Acceptable Financial Accounting Standard in a Period the transaction or arrangement will not meet the definition of *group merger* under the Convention. It is the treatment for purposes of the Acceptable Financial Accounting Standard that is determinative in this respect.

1603. The second part of the definition provides two conditions that must be met as a result of the arrangement. Here, the terms transaction and arrangement should be interpreted broadly. The first condition in subdivision (i) examines the position of an Entity or Entities that meet the definition of the Ultimate Parent Entity prior to the transaction or arrangement but, as a result of it, no longer meet the definition. This rule does not require that all Entities that are part of the transaction or arrangement no longer meet the definition of Ultimate Parent Entity as a result of it. Rather, it requires one or more Entities that met the definition of Ultimate Parent Entity no longer meet it.

1604. The second condition in subparagraph (ii) examines the position of the Ultimate Parent Entity of the Group as a result of the transaction or arrangement. It requires that the Ultimate Parent Entity of the Group as a result of the transaction or arrangement is not an Entity that met the definition of an Ultimate Parent Entity before the transaction or arrangement was undertaken.

Internal fragmentation

1605. The *internal fragmentation* provision in Annex C Section 1(7) provides an exception to the general operation of the revenue test contained in Article 3(1)(a) for a certain type of arrangement, transaction or series of transactions applied to one or more Group Entities of a Group that is controlled by an Excluded Entity, *investment fund* or *real estate investment vehicle*. In such circumstances, it is possible that one or more of such Groups meet the conditions in Article 3(1)(b) and, where relevant, Article 3(2) but fails the condition in Article 3(1)(a) because the Adjusted Revenues of each Group are calculated at a lower level taking into account a smaller sub-set of Group Entities than would have otherwise been the case.

1606. The *internal fragmentation* provision is therefore a specific and targeted anti-avoidance rule, which should only apply in the very limited cases where all the listed conditions are met. It is required to deter potential planning opportunities that would otherwise be available to circumvent the revenue test. Absent the *internal fragmentation* provision, perverse incentives may exist for multinational enterprises to artificially bifurcate their holding structures (possibly more than once) under an Excluded Entity, *investment fund* or *real estate investment vehicle* in order to inappropriately create more than one Entity that meets the definition of Ultimate Parent Entity. As the definition of Adjusted Revenues is based on the Consolidated Financial Statements of a Group prepared by an Ultimate Parent Entity, this would potentially mean that a Group which should meet the revenue test, all things being equal, could intentionally structure

their operations to fail the test, and fall out of scope of the Convention. The *internal fragmentation* provision only applies for purposes of the revenue test. It does not affect the recognition of an Entity as an Ultimate Parent Entity, or the application of the profitability test in Article 3(1)(b) and (2).

1607. The term *internal fragmentation* is defined in paragraph 8. The arrangement, transaction or series of transactions must have occurred on or after the date of public release of the final text of the Convention. This condition is a “legacy rule” that ensures the *internal fragmentation* provision will not apply to any ownership structure below an Excluded Entity, *investment fund* or *real estate investment vehicle* put in place before that date.

1608. The terms “arrangement, transaction or series of transactions” should be interpreted broadly and include any agreement, understanding, scheme, transaction, or a series including more than one, agreement, understanding, scheme or transaction, whether or not they are legally enforceable. One transaction alone may result in an *internal fragmentation*, or it may operate in conjunction with a more elaborate series of transactions (covering a fragmentation that is executed in stages) that, taken together, result in an *internal fragmentation*.

1609. Subparagraph (a) requires that prior to the arrangement, transaction or series of transactions, an Excluded Entity, *investment fund* or *real estate investment vehicle* owns, directly or indirectly, with a Controlling Interest the Ultimate Parent Entity of the Group. Subparagraph (b) requires that following the arrangement, transaction or series of transactions, the Group is separated into two or more Groups each with an Ultimate Parent Entity that is owned directly or indirectly by the same Excluded Entity, *investment fund* or *real estate investment vehicle* with a Controlling Interest. This means that the direct or indirect acquisition by an Excluded Entity, *investment fund* or *real estate investment vehicle* of a new business from a third party, even where it leads to the establishment of a new Ultimate Parent Entity and Group controlled by the Excluded Entity, *investment fund* or *real estate investment vehicle* cannot be an *internal fragmentation*.

1610. An operation that involves, for example, one Group fragmenting into two Groups, one of which is subsequently sold to a third party as part of the same series of transactions, will not qualify as an *internal fragmentation*. This is because as a result of the series of transactions, there is only one Group with an Ultimate Parent Entity that is owned, with a Controlling Interest, directly or indirectly by an Excluded Entity, *investment fund* or *real estate investment vehicle* – the requirement in subparagraph (b) is therefore not met. It is necessary for at least two Groups resulting from the fragmentation to remain under the control of the same Excluded Entity, *investment fund* or *real estate investment vehicle* in order for the arrangement, transaction or series of transactions to qualify as an *internal fragmentation*. However, a case where a Group is fragmented into three Groups, and only one of those is sold to a third party, would meet the definition of *internal fragmentation*.

1611. Paragraph 3 is only relevant if a Group results from an *internal fragmentation* as defined in paragraph 4 and that Group has Adjusted Revenues of EUR 20 billion or less in the Period. The revenue threshold applies to identify only those Groups that do not already meet the revenue test. The *internal fragmentation* provision applies where three additional conditions are met, as provided under subparagraphs (a) through (c), discussed below.

1612. The first condition provides that the *internal fragmentation* provision applies only where a Group meets the profitability test in Article 3(1)(b) and, as applicable, Article 3(2).

1613. The second condition requires that the sum of the Adjusted Revenues of that Group and the other Groups resulting from the same *internal fragmentation* for the Period ending in the same calendar year is greater than EUR 20 billion. In short, this condition requires that the Adjusted Revenues of all Groups,

irrespective of whether those Groups' amount of Adjusted Revenues or *pre-tax profit margin* meets a certain threshold or whether any of those Groups is a Covered Group, that have been fragmented while remaining under the control of the same Excluded Entity, *investment fund* or *real estate investment vehicle* would, in aggregate, meet the revenue test.

1614. The third condition provides a purpose test that will distinguish cases involving genuine non-tax commercial restructuring undertaken at the level of Groups held below an Excluded Entity, *investment fund* or *real estate investment vehicle* and artificial cases that involve avoidance where one of the principal purposes of the restructuring was to circumvent the revenue test. This means that where a restructuring is an *internal fragmentation*, there are two possible outcomes under subparagraph (c). The first outcome is that it is reasonable to conclude, having regard to all relevant facts and circumstances, that failing the revenue test was a principal purpose of the *internal fragmentation*. The second outcome is it is not reasonable to conclude, having regard to all relevant facts and circumstances, that failing the revenue test was a principal purpose of the *internal fragmentation*. Only where the first outcome applies, based on the relevant facts and circumstances of the case, is the condition in subparagraph (c) met and may the *internal fragmentation* provision be invoked (subject to the conditions in subparagraphs (a) and (b)).

1615. Where a restructuring is not an *internal fragmentation*, the principal purposes of that restructuring are not relevant as the *internal fragmentation* provision cannot apply. It will therefore be appropriate to consider whether an arrangement, transaction or series of transaction meets the definition of *internal fragmentation* before considering the principal purposes of the arrangement, transaction or series of transactions.

1616. In order to determine whether one of the principal purposes of the *internal fragmentation* was to fail the revenue test, it is necessary to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement, transaction or series of transactions in place. What the purposes of an arrangement, transaction or series of transactions are is a question of fact which can only be answered by considering all circumstances surrounding the arrangement on a case-by-case basis. It is not necessary to find conclusive proof of the intent of a person concerned with an *internal fragmentation*, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the principal purposes of the *internal fragmentation* was to fail the revenue test.

1617. The application of the *internal fragmentation* provision cannot be avoided by merely asserting that an *internal fragmentation* was not undertaken or arranged to fail the revenue test. Likewise, the application of the *internal fragmentation* provision cannot be justified by merely asserting that one of the principal purposes for undertaking the *internal fragmentation* was to fail the revenue test. All the evidence must be weighed to determine whether it is reasonable to conclude that an *internal fragmentation* was undertaken or arranged for such purpose. The determination requires reasonableness, suggesting that the possibility of different interpretations of the events must be objectively considered.

1618. The reference to "one of the principal purposes" in subparagraph (c) means that failing the revenue test need not be the sole or dominant purpose of a particular *internal fragmentation*. Rather, it is sufficient that where there is more than one principal purpose, at least one of those principal purposes of the *internal fragmentation* was to fail the revenue test. For example, a series of transactions may result in two or more Groups under the same Excluded Entity, *investment fund* or *real estate investment vehicle* in addition to one or more Groups that are sold to a third party in the course of the transactions. In such case, and although it appears clear that the transactions have more than one principal purpose which may include a commercial one, it cannot be automatically concluded that the principal purposes of the transactions do not include failing the revenue test.

1619. A purpose will not be a principal purpose when it is reasonable to conclude, having regard to all relevant facts and circumstances (e.g. internal management considerations, commercial objectives or constraints, regulatory requirements or other relevant advice), that failing the revenues test was not a principal consideration and would not have justified entering into any arrangement, transaction, or series of transactions that resulted in the failure of the revenue test.

1620. For example:

- Where a Group undertakes an *internal fragmentation* but does not meet the revenue test in and/or the profitability test, and cannot reasonably anticipate doing so in the future, it would likely not be reasonable to conclude, having regard to all relevant facts and circumstances, that failing the revenue test was a principal purpose of the *internal fragmentation*. This is because without the *internal fragmentation*, the Group would in any case have not met the revenue test and/ or the profitability test, and thus would have remained outside the scope. It follows that the condition in subparagraph (c) would not be met, and the *internal fragmentation* provision would not apply.
- Where a Group undertakes an *internal fragmentation*, but any disadvantages or downsides associated with the operation under the fragmented structure clearly exceed any potential or actual reduction of tax payable in accordance with the Convention which results from the *internal fragmentation*, it would likely not be reasonable to conclude, having regard to all relevant facts and circumstances, that failing the revenue test was a principal purpose of the *internal fragmentation*. It follows that the condition in subparagraph (c) would not be met, and the *internal fragmentation* provision would not apply.
- Where a Group undertakes an *internal fragmentation*, and the resulting Groups each fail the revenue test but their normal commercial activity is not modified, and there continues to be strong commercial interconnectivity and cohesiveness between them (e.g. through the use of common shared services and assets, through substantial ongoing transactions between the Groups, through a common direction and senior management), and where the Groups cannot demonstrate they have the capacity to be run as separate standalone business with all the necessary functions (e.g. human resources, IT, finance, marketing and senior management), then absent any other facts to the contrary, it would likely be reasonable to conclude, having regard to all relevant facts and circumstances, that the *internal fragmentation* was not carried out for any legitimate business reason and that failing the revenues test was a principal purpose of the *internal fragmentation*. It follows that the condition in subparagraph (c) would be met, and the *internal fragmentation* provision would apply. On the other hand, where a Group holds two distinct and fairly independent business lines and wishes to streamline its corporate structure by separating the business lines into standalone Groups by undertaking an *internal fragmentation* (for example because the Group may wish to shield the established business with a steady profitability from the possible negative impacts of the riskier business), it would likely be reasonable to conclude, having regard to all relevant facts and circumstances (for example by assessing whether strong commercial interconnectivity and cohesiveness between the resulting Groups continue to exist after the transaction; or whether the resulting Groups have the necessary functions to operate as standalone businesses), that the *internal fragmentation* was carried out for legitimate business reasons and that failing the revenues test was not a principal purpose of the *internal fragmentation*.
- Where a Group undertakes an *internal fragmentation* in anticipation and preparation for the sale of a part of the business of the Group but, as part of the same series of transactions, the intended sale has not yet occurred, it does not necessarily follow that a principal purpose of the *internal fragmentation* was to fail the revenue test. As always, the question of whether it is reasonable to conclude that a principal purpose of the *internal fragmentation* was undertaken for this reason

should only be determined after a full review of all relevant facts and circumstances. For instance, where the taxpayer can provide reliable evidence that the restructuring was undertaken as part of genuine pre-sale preparations alongside, for example, pre-sale valuation and due diligence where fees with external advisors have been incurred, or third party negotiations with prospective buyers, and the sale was not merely one of a number of possible options under consideration, then it would likely not be reasonable to conclude that failing the revenue test was a principal purpose of the *internal fragmentation*. In this context, it is the principal purpose or principal purposes that the *internal fragmentation* were undertaken for which are decisive and the outcome is not, of itself, determinative. On the other hand, where the *internal fragmentation* was undertaken and the taxpayer can only provide vague assertions without supporting evidence that the *internal fragmentation* was undertaken to facilitate the sale of the Group, then it would likely not be reasonable to conclude that failing the revenue test was a principal purpose of the *internal fragmentation*.

1621. The principal purpose test provided in subparagraph (c) applies solely to determine whether the *internal fragmentation* provision may deem the revenue test to be met and does not apply for any other purposes of the scope rules, notably the profitability test, or other parts of the Convention.

Dual-listed and stapled structures- Provision

1622. Paragraph 5 contains rules to address potential issues arising from applying the Convention to Groups that are part of the same *dual-listed arrangement* or *stapled structure* (as defined in Annex C Section 1(6)(a) and (b)).

1623. Absent such rules, applying the Convention to *dual-listed arrangements* or *stapled structures* would mean that the same amount of income would be in-scope of the Convention more than once because the Ultimate Parent Entities of separate Groups would each report their consolidated income in their respective Consolidated Financial Statements. In effect, this would mean a full or partial duplication of the amount of income taxable for such Groups because both sets of Consolidated Financial Statements would be taken into account.

1624. To address this, paragraph 5 provides that, where two or more Groups are part of the same *stapled structure* or *dual-listed arrangement*, the Group Entities of those Groups are treated as Group Entities of a single Group for purposes of the Convention. The single Group is deemed to have a single Ultimate Parent Entity. Absent this rule, a *dual-listed arrangement* or *stapled structure* would be considered to have more than one Ultimate Parent Entity. In order to limit the administrative burden for *stapled structures*, in which Consolidated Financial Statements including all Entities of the Groups are being prepared by one Entity, that Entity is deemed to be the Ultimate Parent Entity pursuant to subparagraph (a). In the case of a *dual-listed arrangement*, in which multiple Entities prepare such Consolidated Financial Statements, subparagraph (b) provides that a single Entity will be the Ultimate Parent Entity. Where only one of the Ultimate Parent Entities identified in paragraph 6(a) is resident of a Party for the Period, that Entity shall be deemed the Ultimate Parent Entity of the Group. Where none or all Ultimate Parent Entities are residents of a Party for the Period, the Entity identified that paid the greater amount of *covered taxes* for the year ending in the Period immediately preceding the Period shall be the single Ultimate Parent Entity, or the Entity that is designated by the Group shall be the single Ultimate Parent Entity. In order to ensure consistent outcomes, any designation made under this paragraph will be binding until the designated entity ceases to be an Ultimate Parent Entity.

1625. As a result of these two deeming rules, the Groups that are considered to be a single Group will have one set of Consolidated Financial Statements prepared under a single Acceptable Financial Accounting Standard. The Acceptable Financial Accounting Standard of the Group will be the Acceptable

Financial Accounting Standard under which the Consolidated Financial Statements of the single Ultimate Parent Entity have been prepared.

Dual-listed Arrangement – Definition

1626. A *dual-listed arrangement* is an arrangement whereby two or more Ultimate Parent Entities of separate Groups combine their businesses through contract rather than bringing them under the ownership and control of a single Entity. Under a *dual-listed arrangement*, each Ultimate Parent Entity makes distributions to its owners based on a fixed ratio pursuant to a contract, such as an equalisation agreement, and the activities of the combined Groups are managed collectively as if they were carried out by a single economic entity. As with the definition of *stapled structure* in paragraph 6(b), the definition of *dual-listed arrangement* also requires each Ultimate Parent Entity to prepare Consolidated Financial Statements in which the assets, liabilities, income, expenses and cash flows of all the Entities of the Groups are presented together as those of a single economic unit. However, in contrast to *stapled structures*, the equity interests that carry rights to the profits, capital or reserves of the Ultimate Parent Entities under a *dual-listed arrangement* are quoted, traded or transferred independently in different capital markets.

Stapled Structure – Definition

1627. For purposes of applying the rules in paragraph 5, paragraph 6(b) defines a *stapled structure* in two parts. Subdivision (i) provides that it is an arrangement under which 50 per cent or more of the equity interests that carry rights to the profits, capital or reserves of the Ultimate Parent Entities of separate Groups are “stapled” together as if they were the equity interests of a single Entity. Stapled equity interests are combined together (through their form of ownership, restrictions on transfer, or other terms or conditions) in a way that they cannot be transferred or traded independently. Stapled equity interests that are listed on a securities exchange, are quoted on that exchange at a single price for the combined equity interests. Subdivision (ii) of the definition of *stapled structure* also requires that one of the Ultimate Parent Entities prepare Consolidated Financial Statements in which assets, liabilities, income, expenses and cash flows of the Entities in all of the Groups are presented together as those of a single economic unit.

Section 2 – Application of this Convention to a Group Including one or more regulated financial institutions

Paragraph 1

Application of the Convention to a Group including one or more regulated financial institutions

1628. Paragraph 1 replaces the terms used in the Convention for the purpose of applying the Convention to a Group that would be a Covered Group for a Period under Article 3, and that includes one or more *regulated financial institutions*. There are two prerequisites for applying the regulated financial services exclusion. First, that the Group must first have met the scope thresholds that apply to all Groups, as set out in Article 3. If a Group is not in scope under the ordinary scope thresholds, there is no cause for applying the regulated financial services exclusion. Second, that the Group includes one or more *regulated financial institutions* (defined in Section 2(3)).

1629. The replacement terms in paragraph 1 use the abbreviation “RFS” which stands for regulated financial services. This is a shorthand for a Group that includes one or more *regulated financial institutions*.

The result of paragraph 1 is that a Group is only a Covered Group if that Group has both *non-RFS adjusted revenues* greater than EUR 20 billion and a *non-RFS pre-tax profit margin* greater than 10 per cent in that Period. The effect of paragraph 1 is to remove the revenue and profit (or losses) of the Group that derives from regulated financial services and to apply the ordinary scope thresholds found in Article 3. In the same way, paragraph 1 provides for the application of the ordinary rule on *unused losses*, but only with respect to losses incurred in connection with non-RFS business.

1630. The combined effect of the provisions Article 3 is that the exclusion operates in the following way.

1631. First, if the Group does meet the relevant thresholds in Article 3, then determine whether the Group includes one or more regulated financial institutions. To do so, use the definitions provided in Section 2(3). This is a 'yes or no' question. The purpose of this enquiry is not to quantify the relative size of the regulated financial services business vis-à-vis any other parts of the Group, but to determine whether the Group is eligible for the exclusion.

1632. If the answer is yes (i.e. the Group includes one or more *regulated financial institutions*), then Article 3(4) requires that the Group apply the rules in the Annex C Section 2. The effect of the rules in Section 2 are that the RFS revenue and profits are excluded, and the Group can only be in scope if it meets both of the thresholds in Article 3(1) and (2) as reapplied to the remaining non-RFS revenues and profits.

1633. Second, the Group would apply the *non-RFS adjusted revenue* test (see Section 2(2)(b)). The definition of *non-RFS adjusted revenues* requires the following. First, that the Group identify the revenues from *regulated financial institutions* that are reported in the Adjusted Revenues (i.e. third party revenues). *Regulated financial institutions* are defined in Section 2(3)(a). The Group would deduct those revenues from the Adjusted Revenues. In respect of a Group that includes *insurance institutions*, a further deduction of *related investment revenue* earned by Group Entities that are not *regulated financial institutions* would also be made, if applicable. After these deductions, the Group would test whether the amount of remaining revenues is above EUR 20 billion. If not, then the Group is not a Covered Group because it has not met the non-RFS revenue test. Such a Group would not continue with the following steps. Simplification options apply to this part of the analysis, contained in Annex E Section 2.

1634. Third, if the Covered Group does have *non-RFS adjusted revenues* in excess of EUR 20 billion, it would then determine whether the *non-RFS pre-tax profit margin* exceeds 10 per cent (see Section 2(2)(i)). This definition of *non-RFS pre-tax profit margin* in turn contains the defined term *non-RFS adjusted profit before tax*, which in turn draws on other related terms such as *non-RFS financial accounting profit (or loss)*. These terms together provide the details of the methodology for making the determination of the *non-RFS pre-tax profit margin*. This methodology isolates the RFS portion of the Group and treats the remaining portion of the Group as if it was a separate business, according to the steps described below. As profits or losses relating to the Group's RFS business are disregarded (and are not available for carry-forward), the rules for determining the *non-RFS pre-tax profit margin* and therefore whether the Group is in the scope of the Convention still apply even if the Group's RFS business made a loss.

1635. The methodology starts with identifying the *non-RFS financial accounting profit (or loss)* (see Section 2(2)(f)). This adds the *non-RFS adjusted revenues* and the *non-RFS intra-group revenues* of the Group (in order to reflect intra-group revenue earned by Group entities in transactions with *regulated financial institutions* that were otherwise eliminated in the Consolidated Financial Statements). It then deducts the sum of the *non-RFS expenses* (i.e. expenses incurred by Group Entities that are not *regulated financial institutions* that are reflected in the Consolidated Financial Statements, and in respect of a Group that includes *insurance institutions*, a further deduction of certain expenses related to related investment revenue would also be made, if applicable). Finally, the methodology deducts *non-RFS intra-group*

expenses of the Group (i.e. expenses incurred by Group Entities in transactions with *regulated financial institutions* that were otherwise eliminated in the Consolidated Financial Statements). The resulting figure is the *non-RFS financial accounting profit (or loss)*.

1636. After applying the methodology, the results are retested against the profitability test in Article 3. This is to determine whether the *non-RFS pre-tax profit margin* exceeds 10 per cent. This is done in several steps. First, take the *non-RFS financial accounting profit (or loss)* as calculated under the methodology described above, and make the necessary adjustments that replicate those ordinarily made under the rules for the tax base. This is referred to as the *non-RFS adjusted profit before tax* of the Group for the Period (see Section 2(2)(a)).

1637. Next, calculate the *non-RFS pre-tax profit margin* (see Section 2(2)(i)). This is calculated by taking the *non-RFS adjusted profit before tax* and dividing that amount by the total of the *non-RFS adjusted revenues* and the *non-RFS intra-Group revenues* of the Group for the Period. This calculation does not take into account *relevant net losses*, following the approach in Annex B Section 2(3).

1638. There is an alternative approach to isolating the RFS adjusted revenues and RFS profits. While the main approach above is based on an entity approach (dividing the Group into Entities that are *regulated financial institutions* and Entities that are not), there is a limited option to use a disclosed segment approach. This is when a Group has a *disclosed segment* that meets the definition of a *regulated financial institution segment* (see definition in Section 2(2)(l)). This would typically apply when a conglomerate reports its regulated financial services business in a separate segment (without reporting more than a de minimis amount of other non-RFS business in that segment), and is designed to allow the Group to exclude the RFS business by using the results as reported in that *disclosed segment*. In order to apply this approach, the following steps would be taken. First, determine whether the Group's *disclosed segment* meets the definition of *regulated financial institution segment*. If so, identify the Group's Adjusted Revenues (i.e. the term as generally used throughout the Convention, rather than that term as replaced in Annex C Section 2). From that figure, deduct the revenues reported by that *regulated financial institution segment*. Apply the *non-RFS adjusted revenue* test to determine whether the *non-RFS adjusted revenues* exceed EUR 20 billion. If not, the Group is not in scope. If so, proceed to determine the *non-RFS pre-tax profit margin*. In order to do this, the same calculations are made as above, but looking at the *regulated financial institution segment* rather than individual *regulated financial institution* Entities.

1639. If the result is that the Group has a *non-RFS pre-tax profit margin* of equal to or below 10 per cent, the Group is out of scope for the Period and there is no need to consider Article 3(2) (i.e., the averaging provision). However, a further test is then applied in the case that a Group satisfies the condition in Article 3(1)(a) but does not satisfy the condition in Article 3(1)(b), to determine if any one of the *disclosed segments* meets the *covered segment* rule, after having removed the results associated with RFS. For example, if the Group had two *disclosed segments*, and the result of determining the *non-RFS pre-tax profit margin* is that the combined *non-RFS pre-tax profit margin* is 9 per cent, but on its own the *non-RFS pre-tax profit margin* of one of those *disclosed segments* is 11 per cent (and that segment reports revenues in excess of EUR 20 billion), then that segment is in scope under the *covered segment* rules (subject to meeting the requirements of Article 3(2) as modified by Annex C Section 4), but only with respect to the non-RFS portion of the segment. The other segments are out of scope.

1640. If the result of determining the *non-RFS pre-tax profit margin* is that the Group does have a *non-RFS pre-tax profit margin* in excess of 10 per cent, then it is a Covered Group (and there is no further application of the *covered segment* rules). In other words, the Convention is applied to the aggregated profits of all of the non-RFS parts of the Group (i.e. the Convention is not separately applied to each segment on its own).

1641. Finally, when the Group is in scope (or a *covered segment* is in scope) after the removal of the RFS portion, then the rest of the Convention applies, but only with respect to the non-RFS portion of the Group (or *covered segment*). For example, the nexus test and revenue sourcing rules are only applied with respect to *non-RFS adjusted revenues*; the formula for the allocation of profits is only with respect to non-RFS profits; the *marketing and distribution profits safe harbour adjustment* only applies with respect to *non-RFS adjusted revenues*; and the calculations and obligations related to elimination of double taxation only apply with respect to non-RFS profits.

1642. The definitions included in Annex C Section 2 apply not just for Article 3, but for purposes of the whole Convention. The effect of paragraph 3 is therefore to ensure that the Convention excludes the results of *regulated financial institutions* that are part of a Covered Group.

1643. Article 3(5) also makes provision for an exclusion in respect of a *qualifying extractives group* and Article 3(8) makes an adjustment in respect of a *defence group*. In the case of a Group that includes a *regulated financial institution* and that is also a *qualifying extractives group* and / or a *defence group*, both the provisions in Article 3(4) and / or Article 3(5) and / or Article 3(8) apply. Such a group may apply the exclusions in either order, with the cumulative result that only the non-RFS and non-extractives and non-defence part of the Group can be subject to the remaining provisions of the Convention. However, if the Group is not in scope of the Convention after the application of only one or two of those exclusions, it would not need to apply the other exclusion(s).

Paragraph 2

General definitions

1644. Paragraph 2 provides for definitions that apply to a Group that has one or more *regulated financial institution* for purposes of the Convention.

1645. Subparagraph (a) defines the term “non-RFS adjusted profit before tax”. The rules follow closely the mechanism in Annex B Section 2 to make adjustments to the tax base, and to deduct *non-RFS relevant net losses*, except that it is based on the Covered Group’s *non-RFS financial accounting profit (or loss)*.

1646. Subparagraph (b) defines the term “non-RFS adjusted revenues”. This term is relevant to the revenue test in Article 3(1)(a), and as the basis for determining and allocating the amount of *taxable profit* of a Covered Group that includes a *regulated financial institution*. *Non-RFS adjusted revenues* of a Group for a Period mean the Adjusted Revenues of the Group for the Period modified to exclude all revenues that are derived by Group Entities that are *regulated financial institutions*. This also requires deducting *related investment revenue* that was included in the Consolidated Financial Statements and that was derived by Group Entities that are not *regulated financial institutions*. This is required to reflect the substantive rule that recognises *related investment revenue* as, in effect, belonging to a *regulated financial institution* that is an *insurance institution* even if earned by a separate Entity that is not itself a *regulated financial institution* (see discussion of the term *related investment revenue* under paragraph 3(q)). By starting with the defined term ‘Adjusted Revenues’ of the Group (i.e. the term as generally used throughout the Convention, rather than that term as replaced in Annex C Section 2) it means that the term *non-RFS adjusted revenues* only excluded revenues from *regulated financial institutions* that were otherwise included in the Consolidated Financial Statements (i.e. third party revenues). As such, the revenue test in Article 3(1)(a) ensure that the non-RFS revenue test will only be met where the third-party revenue of the non-excluded Group Entities exceeds EUR 20 billion.

1647. The definition of *non-RFS adjusted revenues* make provision for an election to use a calculation based on a *regulated financial institution segment*. This approach is discussed below in paragraph 1658.

1648. Subparagraph (c) defines the term “non-RFS eligible net losses”. This definition follows that found in Annex B Section 2(5)(a), but ensures that only losses from Group Entities that are not *regulated financial institutions* are included in the calculation. The same approach is taken with respect to extractives.

1649. Subparagraph (d) defines the term “non-RFS eligible prior period”. This definition follows that found in Annex B Section 2(5)(b), but applies by reference to *non-RFS unused losses*. This ensures that only those losses related to Group Entities that are not *regulated financial institutions* are captured.

1650. Subparagraph (e) defines the term “non-RFS expenses”. The *non-RFS expenses* of a Group for a Period are the total expenses of the Group deducted in calculating the Financial Accounting Profit (or Loss) of the Group less the total expenses incurred by *regulated financial institutions*. This definition mirrors that of “non-RFS adjusted revenues”, capturing non-RFS third party expenses only (as a result of the reference to the Financial Accounting Profit (or Loss) of the Group). It also includes expenses directly associated with related investment revenue incurred by Group Entities that are not *regulated financial institutions* (such as custodian fees or transaction fees incurred with respect to the *related investment revenue*). This reflects the need to reflect the substantive rule for *related investment revenue* which is relevant to Groups that include *insurance institutions*, as described in paragraph 3(q), and mirrors the same adjustment made to the definition of *non-RFS adjusted revenues* above. This definition applies for the purpose of determining the Group’s *non-RFS financial accounting profit (or loss)*.

1651. Subparagraph (f) provides a specific rule to calculate the Covered Group’s *non-RFS financial accounting profit (or loss)*. The aim is to isolate the profits (or losses) of the non-RFS part of the Covered Group (i.e. of all the Group Entities that are not *regulated financial institutions*) as though it formed its own separate Group. As such, the Covered Group’s *non-RFS financial accounting profit (or loss)* comprises third-party revenues and expenses of Group Entities that are not *regulated financial institutions*, as well as intra-group revenues derived and expenses incurred by those Entities in transactions with the *regulated financial institutions* of the Covered Group.

1652. The Covered Group’s *non-RFS financial accounting profit (or loss)* is calculated by (a) summing the *non-RFS adjusted revenues* of the Group and the *non-RFS intra-group revenues* of the Group, and (b) deducting the sum of *non-RFS expenses* of the Group and the *non-RFS intra-group expenses* of the Group. *Non-RFS adjusted revenues* and *non-RFS expenses* are defined in Annex C Section 2(2)(b) and (e) respectively, to comprise the third-party revenues and expenses of Group Entities that are not *regulated financial institutions*. *Non-RFS intra-group revenues* and *non-RFS intra-group expenses* are defined in Annex C Section 2(2)(g) and (h) respectively, to comprise the intra-group revenues and expenses of Group Entities that are not *regulated financial institutions* derived from transactions with *regulated financial institutions* of the Group.

1653. Subparagraph (g) defines the term “non-RFS intra-group expenses”. These expenses are the sum of the expenses of Group Entities that are not *regulated financial institutions* that are incurred in transactions with Group Entities that are *regulated financial institutions*. This definition mirrors that of “non-RFS intra-group revenues” to capture the expenses incurred by the non-RFS part of the Group from intra-group transactions with the Group’s *regulated financial institutions*. This definition applies for purposes of determining the Group’s *non-RFS financial accounting profit (or loss)*.

1654. Subparagraph (h) defines the term “non-RFS intra-group revenues” to mean the sum of the revenues of Group Entities that are not *regulated financial institutions* that are derived from transactions with *regulated financial institutions* of the Group. This definition captures the revenues earned by the non-RFS part of the Group from intra-group transactions with the Group’s *regulated financial institutions*. This definition applies for purposes of determining the Group’s *non-RFS financial accounting profit (or loss)*.

1655. Subparagraph (i) defines the term “non-RFS pre-tax profit margin”. This is calculated by taking the *non-RFS adjusted profit before tax* of the Group for the Period, without taking into account *non-RFS relevant net losses*, and dividing that amount by the total of the *non-RFS adjusted revenues* and the *non-RFS intra-Group revenues* of the Group for the Period.

1656. Subparagraph (j) contains the definition of “non-RFS relevant net losses”. These are the losses to be carried forward and deducted in the calculation of the Covered Group’s *non-RFS adjusted profit before tax* for a Period. The definition ensures that the calculation of *relevant net losses* for Groups that includes a *regulated financial institution* only includes the appropriate losses (i.e. not the losses that relate to RFS). *Non-RFS relevant net losses* include the same two components as *relevant net losses* in the general rules under Annex B Section 2(3), except they are calculated with reference only to the appropriate losses. First, *non-RFS relevant net losses* always includes the *non-RFS eligible net losses* (i.e. historical losses incurred within the Covered Group itself). Second, they can also include *transferred losses* (i.e. historical losses incurred by a separate business that has since been transferred to the Covered Group). Such *transferred losses* are determined in accordance with the general rules in Annex B Section 2(3)(b) and (4) (including as they relate to the modalities of lodging the election), but with reference only to the appropriate (i.e. non-RFS) losses of *the transferred entity or group, or predecessor group*. This second part of the definition is only relevant if the Covered Group has made an election to recognise *transferred losses* in respect of a particular business combination or division. See the discussion in Annex B Section 2(3)(b) for further detail. Note that losses that relate to the RFS business are not carried forward. In the event that the RFS business becomes profitable in the future, there is no need for using such previous losses, given that the profit relating to the RFS business is excluded in any event. The same approach is taken with respect to extractives.

1657. Subparagraph (k) defines the term “non-RFS unused loss”. This definition follows that found in Annex B Section 2(5)(h), but the profit that the loss is calculated by reference to is the *non-RFS financial accounting profit (or loss)* of a prior Period and therefore removes the profits and losses of *regulated financial institutions*.

1658. Subparagraph (l) defines the term “regulated financial institution segment”. The purpose of this definition is to permit a Group that reports a *disclosed segment* in its Consolidated Financial Statements that almost exclusively reports revenue from the relevant *regulated financial services activities* to use the segment results in calculating the *non-RFS adjusted revenues* and *non-RFS pre-tax profit margin*. Mechanically, it does this because the definition is in turn referenced in the definition of *non-RFS adjusted revenues, non-RFS intra-group revenues, non-RFS expenses* and *non-RFS intra-group expenses*.

1659. This approach only applies if the Group elects to use this approach, and if a *disclosed segment* meets the definition of a *regulated financial institution segment*. The first condition is that the segment must include at least one *regulated financial institution*. The second condition is that all *regulated financial institutions* of the Group must be included in the *disclosed segment*. This means that all *regulated financial institutions* of the Group will be captured by using this segment approach, and none are left out of the calculations by virtue of being reported in a different segment that does not meet the definition of a *regulated financial institution segment*. In practice, this will mean that the disclosed segment approach can only be used by conglomerates that perform financial services alongside other businesses, while groups that perform mostly financial services will use the entity approach.

1660. The third requirement in the definition is a revenue test. At least 90 per cent of the segment revenues must be from *total licensed reported revenue* attributable to relevant activities listed in condition (iii) of the applicable definition of a *regulated financial institution* or revenue of a *depository institution*.

1661. This is a stricter test than the entity-by-entity approach otherwise required. In referring to the *total licensed reported revenue* attributable to relevant activities listed in condition (iii), it means that most of the revenue must be from the specific activities listed in the definitions, rather than at least 75 per cent of revenue from such activities. For example, a Group reports a *disclosed segment* that includes three Entities: one is an *asset manager*, one is an *insurance institution*, and one is an Entity that was not a *regulated financial institution*. In order to meet the definition, at least 90 per cent of the *segment adjusted revenues* would have to be *total licensed reported revenue* from the activities identified in subdivision (iii) of the definition of *asset manager* or *insurance institution* or a combination of both. The revenue test is split into sub-conditions (A) and (B). This is because in respect of the types of *regulated financial institutions* contained in (A), a *total licensed reported revenue* test applies, but in respect of *depository institutions*, a balance sheet test applies. Any combination of A and / or B is permitted, and the drafting is only separated to reflect the different mechanical calculations.

1662. The fourth condition is that all *segment entities* in that *disclosed segment* are overseen by and subject to the authority of a relevant financial regulator. This means that the regulators are assessing the capital requirements with respect to the entirety of the activities in the *disclosed segment*. The language accounts for cases where there may be more than one regulator responsible for reviewing *segment entities* that report in the *disclosed segment*. Provided that all *segment entities* in the *disclosed segment* (including any that do not meet the definition of *regulated financial institution*) are subject to the oversight by one or more regulators, the condition is met.

1663. The final condition is that any *segment entity* of the *disclosed segment* that provides intra-group services to other Group Entities meets the definition of *regulated financial institution*. This means that if the *disclosed segment* includes Entities that provide services to other Group Entities but that do not otherwise meet the definition of a *regulated financial institution*, then the segment will not qualify as a *regulated financial institution segment*. For example, the presence of an entity that is a *group captive entity* or *group treasury entity* will disqualify the segment, as would the presence of an Entity that is performing support services such as acting as managing agents for Group *insurance institutions* because it will not meet the definition of *regulated financial institution service entity*.

1664. If a Group chooses not to use the *regulated financial institution segment* option, it would continue to use the entity approach contained in the rules. The Convention does not require that a Group use only one approach for every Period. In the event that a Group used the entity approach for one or more Periods and then elected to use the *regulated financial institution segment* option in a subsequent Period, recalculation based on the *regulated financial institution segment* rule is not required with respect to the averaging mechanism and losses for prior Periods in which the Covered Group did not elect that rule.

Paragraph 3

Definition of regulated financial institution and related terms

1665. Paragraph 3 contains the definition of a *regulated financial institution*, and all other definitions necessary to support that definition.

1666. The term *regulated financial institution* means an *asset manager*, *depository institution*, *credit institution*, *investment institution*, *insurance institution*, *mixed financial institution*, and a *regulated financial institution service entity*. These types of institution have been agreed as falling within the exclusion, because of the unique nature of the regulation that applies to them (as reflected within each of the relevant definitions, and which generally require the holding of capital which typically has the effect of *taxable profits* being recorded in the Jurisdiction of regulation), and to recognise the particular technical and practical challenges that would otherwise be associated with their inclusion in the scope of the Convention. An Entity

which meets one of these definitions is a *regulated financial institution*, irrespective of whether it would also qualify as another type of *regulated financial institution*.

1667. The definition further provides that neither a *group captive entity*, nor a *group treasury entity* would qualify as a *regulated financial institution*. As the definition of *regulated financial institution* is the governing definition for this Annex C Section 2(3), the prohibition on *group captive entity* or *group treasury entity* from benefiting from the exclusion prevails even if such Entity could otherwise meet an individual definition of an *asset manager*, *depository institution*, *credit institution*, *investment institution*, *insurance institution*, *mixed financial institution*, or a *regulated financial institution service entity*. This is not to suggest such activities would otherwise be considered to be regulated financial services, but is included for the avoidance of doubt.

1668. Each definition of *regulated financial institution* starts with the definition of a Group Entity. The term Group Entity means an Entity, other than an Excluded Entity, that is included in a Group and “Group” means an Ultimate Parent Entity and any other Entities, whose assets, liabilities, income, expenses and cash flows are included in the Consolidated Financial Statements of the Ultimate Parent Entity, or would have been so included if the Ultimate Parent Entity had prepared Consolidated Financial Statements. This term is used to ensure that it does not include an Excluded Entity. This means that the definition of Excluded Entity is applied in priority to the exclusion for regulated financial services.

1669. The term “Entity” is defined in Article 2 and means any juridical person or arrangement that prepares, or is required to prepare, separate financial accounts. In practice, this means that an Entity will include any branches, whether or not there is a permanent establishment under domestic law and the applicable tax treaty. By using the term “Entity”, the definition of a *regulated financial institution* is not separately applied to each individual branch (except in the context of licensing), even where the branch prepares separate financial accounts. This means that when assessing the regulation and activities carried out by the Entity, it is tested as a whole (including its branches), rather than each branch being tested separately.

1670. In taking an Entity approach, the rules test whether a Group Entity meets the definition of a *regulated financial institution*. If so, the rules exclude the financial results of that Entity in full. Likewise, the financial results of a Group Entity that does not meet that definition are included in full. This means that whether one Group Entity fails to meet the test in one Jurisdiction (for example, because of the specific limits of the regulatory regime in that Jurisdiction) would not affect whether a different Group Entity meets the test in another Jurisdiction.

Structure of definitions of regulated financial institution

1671. Each definition of *regulated financial institution* comprises a number of elements, all of which must be satisfied. These elements cover the nature of licensing and regulation that the Entity must be subject to, and the nature of the financial services activities undertaken. Each is discussed in general terms below, and the specific requirement is further discussed in the context of each definition.

Licensing requirement

1672. The first requirement is a licensing requirement. This recognises that around the world, the ability to carry out the business of a financial institution is conditional on receiving specific authorisation to do so from the relevant regulatory authority, and that authority exercises its supervisory function with respect to the activities and conduct of the licensed entity. The term licensed should be interpreted broadly and understood to cover circumstances where an Entity is authorised or registered to carry on the relevant business.

1673. The specific details of the licence and the nature of that supervision are not required to be tested in detail; rather, this condition is a question of fact as to whether the Entity has the relevant licence, permission or authority.

1674. The licencing requirement condition refers to being “licensed” under the law or regulations of a Jurisdiction in which the Group Entity does that business. This means that the licensing requirement is tested looking at the operations in the local Jurisdiction. Where the Entity has separate branches carrying on the relevant business in one more other Jurisdictions, the licensing requirement would need to be tested in respect of each branch. This reflects the manner in which the relevant licensing and supervision regimes operate around the world. This means that if a branch in a local Jurisdiction was not licensed as set out in the relevant definition, then the revenue of that branch would not count towards the *total reported revenue* derived from the relevant activities of the Entity (i.e. the numerator in the 75 per cent revenue test, where relevant). This rule is reflected in the definition of *total licensed reported revenue*.

1675. The language in respect of the licensing part of the definition of each *regulated financial institution* also makes provision for passporting arrangements in Europe. The licensing requirement recognises that an Entity can carry out its financial services business in any European Economic Area (EEA) Member States by virtue of a license issued by a *competent authority* in one EEA Member State, and such arrangement would meet the licensing requirement. Further, the language covers equivalence regimes, where an Entity that is licensed to carry on the business of financial services in one Jurisdiction is also permitted to carry on that same business in another Jurisdiction under their laws.

Regulation requirement

1676. The second requirement is a regulation requirement. The term “regulated” in this context is specific to the type of regulation that applies only to certain financial services, rather than a more general concept covering government oversight or consumer protection. The cornerstone of this regulation for purposes of the Convention is the requirement to hold capital. This is also a difference, for example, between a *regulated financial institution* as defined in the Convention to other financial service firms such as payment processing service or fintech, which are subject to a range of regulations but are not subject to requirements to hold capital.

1677. The elements of the definitions concerning regulation for purposes of the exclusion from the scope of the Convention are intentionally high-level and principles based. They recognise that there are broadly accepted international approaches to capital adequacy requirements that can serve as a common framework for the exclusion. At the same time, the definitions do not provide for a detailed technical examination of specific domestic regulatory regimes.

1678. There are internationally accepted approaches to capital adequacy, such as:

- The Core Principles for Effective Banking Supervision that have been issued by the Basel Committee on Banking Supervision;
- The Objectives and Principles of Securities Regulation and the Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation published by the International Organisation of Securities Commissions (IOSCO);
- Regimes in accordance with the Insurance Core Principles of the International Association of Insurance Supervisors (IAIS).

1679. These internationally accepted approaches to capital adequacy are implemented through domestic law. The common concept across these regulatory principles is that the assessment of the

amount of capital required to be held by the financial institution must take risks into account. In implementing this principle, the bodies responsible for these international standards have recognised that domestic regulators may adopt different approaches at a granular level to prescribing capital adequacy requirements, to take account of the varied levels of complexity and risks posed by financial services businesses in different national contexts. For this reason, it would be difficult, if not impossible, to prescribe in detail the requirements capital adequacy regulatory regimes must meet for the exclusion from the scope of the Convention to apply that would be capable of application to every Jurisdiction.

1680. Furthermore, it would not be feasible for tax administrations and/ or a *review panel* convened in accordance with Part V Administration and Certainty to undertake a qualitative analysis of the details of particular regulation to verify whether the particular regulation imposed by a local regulator is consistent with these international approaches. That is the mandate and area of competence of other bodies, such as the Basel Committee on Banking Supervision. It would be a significant burden on the tax certainty process to assess whether the domestic regulatory regime applying to a given financial institution meets a particular international standard, given the complexity of financial services regulation. Finally, recognising that it is a wholly separate discipline from tax, it would be inappropriate for tax administrations to do so, given the role of other international bodies and regulators in this area.

1681. For these reasons, the underlying principle in referring to this regulation at a high level is to defer to the expertise and mandate of the standard-setters of financial regulation, and not to create new or different regulatory requirements for purposes of the Convention. By referring to high-level principles, the Convention accommodates a change in those standards or their assessment, as may be determined by the international standard-setters, without requiring a change to the Convention. In some cases, the definitions specify the type of the capital adequacy requirements that should apply (e.g., those that reflect the Core Principles for Effective Banking Supervision or are risk-weighted). Confirming that the capital adequacy requirements meet the specified type should not infringe on the competence of other bodies. Confirming that the specified type of capital adequacy requirements applies does not involve a qualitative assessment of those standards through the tax certainty process. Rather, it should be understood as a binary control to ensure that the specified requirements apply.

1682. In essence, the test for regulation for purposes of the Convention means that the Entity must be subject to capital adequacy requirements under the domestic law of a Jurisdiction that has implemented regulation that reflects the core principles recognised by the relevant international standard setter (other than where the international standard as it applies to certain asset management Entities may impose alternative regulatory requirements than a capital requirement, as explained below). This means it is a question of fact as to whether the Entity is subject to the relevant regulation imposed under the implementing domestic legislation. It does not require that the Jurisdiction where the Entity is subject to regulation be assessed by *international organisations* as compliant with every aspect of the relevant international standard or even compliant overall; nor does it require that the Jurisdiction has been recently reviewed by the relevant standard setting body or other review body.

1683. The test for regulation applies at an Entity level, in line with the general approach to the design of the rules in the Annex to Article 3. The rules do not require that the Entity is subject to capital adequacy requirements in each branch location, but instead require that the Entity (as a whole) is subject to capital adequacy requirements under the law of the home Jurisdiction where the Entity is established and as assessed by the home Jurisdiction regulator. This accommodates both cases where the regulator may require a separate, appropriately capitalised Entity to be established to operate within a market, and cases where the regulator instead requires local branches of a foreign Entity to be able to call on sufficient capital of the Entity as a whole. This is different to the case of licensing described above. Where a branch was not separately required to hold its own capital, this would not disqualify the revenue of the branch from counting toward the *total reported revenue* of the Entity. For this purpose, the term established means the

Jurisdiction where the entity is incorporated if it is a corporate entity. However, the term established is used to facilitate the inclusion of non-corporate Entities such as partnerships which would more appropriately be described as “established” rather than incorporated.

Activities requirement

1684. The third element of each definition of regulated financial institution focuses on types of activities that the Entity is carrying out (sometimes referred to as “relevant activities”).

1685. This is tested by way of a threshold which is included in each definition. These thresholds are designed to ensure that the Entity is conducting the business of a *regulated financial institution* as defined. In this regard, it is noted that the types of activities carried out by *regulated financial institution* evolve over time. As with any other aspect of the rules, the Conference of the Parties may need to make changes or additions to the rules as the industry develops.

Overview of Remaining Definitions

1686. The definitions are presented in alphabetical order. Thematically the definitions can be grouped as follows:

- *Regulated financial institution*: covers seven types of entity: *depository institution*; *credit institution*; *investment institution*; *insurance institution*; *asset manager*; *mixed financial institution*; and a *regulated financial institution service entity*. It does not cover *group captive entity* or *group treasury entity*.
- Definitions relevant to *asset manager*: *asset manager*; *financial assets*; *investment fund*; *real estate investment vehicle*; *total licensed reported revenue*; *total reported revenue*.
- Definitions relevant to *credit institution*: *credit institution*; *total licensed reported revenue*; *total reported revenue*.
- Definitions relevant to *depository institution*: *deposit*; *depository institution*.
- Definitions relevant to *insurance institution*: *annuity contract*; *financial risk*; *insurance contract*; *insurance institution*; *insurance or reinsurance risk*; *related investment revenue*; *total licensed reported revenue*; *total reported revenue*.
- Definitions relevant to *investment institution*: *financial asset*; *investment institution*; *total licensed reported revenue*; *total reported revenue*.
- Definitions relevant to *mixed financial institution*: *asset manager*; *credit institution*; *insurance institution*; *investment institution*; *mixed financial institution*; *total licensed reported revenue*; *total reported revenue*.
- Definitions relevant to a *regulated financial institution service entity*: *asset manager*, *credit institution*, *depository institution*, *group captive entity*, *group treasury entity*, *insurance institution*, *investment institution*, *mixed financial institution*, *regulated financial institution service entity*; *total reported revenue*.

Annuity contract

1687. The definition of an “annuity contract” is relevant for the definition of an “insurance institution”. This is because subdivision (iii) of the definition of an *insurance institution* tests whether the Entity derives a sufficient proportion of its revenue from *insurance contracts*, *annuity contracts* and *related investment revenue*.

1688. The term *annuity contract* means a contract under which the issuer agrees to make payments for a period of time determined in whole or in part by reference to the life of one or more individuals. The term *annuity contract* also includes a contract under which the issuer agrees to make one or more payments for a term of years and that is recognised as such in accordance with the law, regulation or practice of the Jurisdiction in which the contract was issued.

Asset manager

1689. The term “asset manager” means a Group Entity that meets the licencing requirement in subdivision (i), the regulatory requirement in subdivision (ii), and the activities requirement in subdivision (iii).

1690. Subdivision (i) of the definition is the licencing requirement. It means that the Entity must be authorised to carry on asset management as a business under the laws or regulations of a Jurisdiction where it does business (or as permitted under passporting or equivalence arrangements). This requirement will often be referred to as an “authorisation”, “licence” or a “registration” under local law and these terms are often interchangeable. This means that it must be legally permitted by the relevant supervisory authority to carry out the activities typically carried out in the course of asset management, i.e., those listed in subdivision (iii).

1691. The nomenclature of the licence may state something other than “asset management”; for example, it may be referred to as an “investment manager licence”, “fund manager licence”, or “investment firm licence”. It would also include an Entity licenced as a wealth manager, which would typically involve providing the services listed in subdivision (iii) to individuals (and possibly combined with other activities under the definition of an *investment institution*) within a broader context of performing such services having regard to the client’s financial position as a whole (such as their debt obligations or retirement goals).

1692. Although the terminology used may differ between Jurisdictions, what is common is that the licence must be for the business of what would commonly be understood as asset management. For example, it would not cover a licence to act as a trust and company service provider, which only nominally holds assets on trust for other persons (i.e. the beneficiaries of the trust).

1693. Subdivision (ii) of the definition is the regulation requirement. It refers to being subject to requirements reflecting the Objectives and Principles of Securities Regulation as adopted by the IOSCO and the related implementing methodology. The presence of the relevant requirements are tested by reference to the law or regulations of the Jurisdiction in which that Group Entity is established.

1694. The IOSCO Principles cover a range of actors in the financial system. There are two parts of those Principles that are relevant to the regulation of asset management: Part G (principles for Collective Investment Schemes) and Part H (principles for Market Intermediaries).

1695. Part G covers those who market and operate Collective Investment Schemes (i.e. those who attract investors in the *investment funds* and those with overall responsibility for management and performance of the functions of the *investment fund*, such as managing the asset portfolio). The Principles

in Part G require that Jurisdictions establish rules to ensure that the investors in such vehicles are protected, but do not require capital to be held in order to meet the standard. Part G (Principles 24 – 27) requires Jurisdictions to ensure appropriate standards are in place for:

- the eligibility, governance, organisation and operational conduct of those who wish to market or operate a collective investment scheme;
- governing the legal form and structure of collective investment schemes and the segregation and protection of client assets;
- disclosure obligations to facilitate an investor’s evaluation of the suitability of a particular collective investment scheme and the level of the investor’s interest in the scheme; and
- a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.

1696. Principle 28 of Part G applies to hedge fund managers / advisers, to the extent not otherwise covered as those who market, manage and operate collective investment schemes. The IOSCO Methodology provides that this includes registration / authorisation; internal organisation and operational conduct requirements; standards for managing conflicts of interest; disclosure requirements; prudential requirements that reflect the risks posed; and requirements relating to supervision and enforcement. In this regard, the IOSCO Methodology specifically acknowledges that Jurisdictions take different approaches to prudential requirements, which may not necessarily include the imposition of capital requirements; and that such approach should not imply that a Jurisdiction has not implemented the requirements.

1697. Part H applies to “market intermediaries”. These are described by IOSCO as generally including those who are in the business of managing individual portfolios, executing orders and dealing in, or distributing, securities (and, as such, they may overlap with *investment institutions*, as discussed below). In such cases, the IOSCO Principle 30 provides that “[t]here should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake”. As such, the capital requirements that apply to this type of asset management are very similar to those that apply to other *regulated financial institutions* under Annex C Section 2. This includes initial and ongoing capital requirements that covers market, credit, liquidity and operational risks, the amount of which is related to the nature of the risks and the amount of risks, the ability to absorb losses in the event of an adverse market event, and the ability to conduct an orderly wind down.

1698. In addition, Part H applies to those businesses that are “investment advisors” which in some Jurisdictions are categorised differently to market intermediaries. The IOSCO Principles describe investment advisors as being those (i) that deal on behalf of clients; (ii) that are permitted to have custody of client assets; or (iii) investment advisers who neither deal on behalf of clients nor hold or have custody of client assets nor manage portfolios, but who offer only advisory services without offering other investment services. In the first two cases, the requirements under Part H apply as discussed for market intermediaries, including capital requirements. In the third case, such Entities would not meet the activities test in subdivision (iii) below.

1699. Subdivision (iii) provides the activities requirement. It provides that the Entity’s *total licensed reported revenue* attributable to one or more of the prescribed activities equals or exceeds 75 per cent of the Group Entity’s *total reported revenue* during the Period. This is tested using the overall revenue earned by the Entity from the activities listed in subdivision (iii) as reported on the financial statements submitted to the regulator but excluding any such revenue attributable to Jurisdictions where the Entity is not licensed, as compared to the total revenue earned by the Entity during the Period. If the income statement of the

Entity is not submitted to the regulator, the figures are based on the revenue reported in the Entity's financial statements. In the context of an *asset manager*, the *total reported revenue* from the prescribed activities includes service fees and performance fees. The Group Entity's *total reported revenue* during the Period means the gross revenues from all activities.

1700. The prescribed activities listed in subdivision (iii) have three elements, all of which must be satisfied.

- the activity: investing in, managing, distributing, risk management and certain advisory services;
- in certain vehicles or assets: an *investment fund*, *real estate investment vehicle*, *financial assets*, or money; and
- for another person: the activity must be for or on behalf of other persons.

1701. With respect to the first element, this reflects the nature of the activities undertaken by an *asset manager*.

- 'Investing in' means that the *asset manager* may itself hold the investment.
- 'Managing' means that the *asset manager* may be making decisions about investments in particular assets and asset classes and asset disposition, in line with the defined investment policy, and includes portfolio management.
- 'Distributing' means that the *asset manager* may be responsible for marketing and selling interests in a particular investment product or fund or other *financial asset*.
- 'Risk management' means that the *asset manager* may be engaged to provide risk management services (such as analysis or advice on the overall portfolio and balance of risks across asset classes and geographies having regard to the investor profile) with respect to a broad portfolio of underlying funds, *financial assets* or investments, separate to the discretionary portfolio management function.
- The advisory services and administration that form part of this definition (in clause (B)) are the provision of investment advice or administration in support of the other asset management activities that are performed by the Entity as referred to in the preceding bullet points (contained in paragraph 3(b)(A)). 'Administering' means that the *asset manager* may be responsible for the operational functions of a fund, such as calculating net asset values and redemption values, providing accounting services or providing administrative services in respect of *financial assets* such as recording ownership and changes in ownership or returns on *financial assets*. This means that an Entity only providing investment advice, such as a financial planner, would not qualify as an *asset manager*; likewise an entity only performing administration (or only performing investment advice and administration) would not qualify as an *asset manager*.

1702. The second element recognises that *asset managers* may perform those activities with respect to a wide range of asset classes. It includes *investment funds* and *real estate investment vehicles*, *financial assets*, and money. This element is intentionally broad to ensure that traditional assets (such as interests in widely held mutual funds), as well as alternative investments (such as investments through *investment funds* in infrastructure, real estate and controlling interests in other companies), are all included.

1703. The third element is that the activities must be for another person, and not for one's own account. That other person need not be an unrelated party, and may be another Entity within the Group. The language "for or on behalf of other persons" means that it includes both the management of investments for an investor, as well as the management of investments for a third party, such as the management of segregated accounts or pension plans on behalf of clients.

Credit institution

1704. The term *credit institution* means a Group Entity that meets the licencing requirement in subdivision (i), the regulatory requirement in subdivision (ii), and the activities requirements in subdivisions (iii) and (iv).

1705. The licencing requirement in subdivision (i) means that the Entity must be authorised to carry on the business of lending funds under the laws or regulations of a Jurisdiction where it does business (or as permitted under passporting or equivalence arrangements). This means that it must be legally permitted by the relevant supervisory authority to carry out the activities typically carried out by a lending institution, which would include those listed in subdivision (iii). The nomenclature of the licence may be something other than "credit institution"; for example, it may be referred to as a bank, mortgage institution, building society, credit card issuer, lender or it may be described as an institution that is authorised to lend, extend credit, etc.

1706. The regulatory requirement in subdivision (ii) refers to being subject to capital adequacy requirements that incorporate a risk-based measure. The presence of the relevant requirements are tested by reference to the law or regulations of the Jurisdiction in which that Group Entity is established. This means that the relevant regulator must require the holding of a sufficient amount of capital, and that such amount is calculated by reference to the nature of the risk taken on, and the level of the risks assumed by the Entity. This may be calculated using a different methodology as compared to approaches that apply to *depository institutions* under the Basel Core Principles, but the method must be one that takes account of the risks particular to the institution. The risks that would typically be considered in this assessment include credit risk, market risk, and operational risk, assessed having regard to the size, liabilities or execution volumes.

1707. This could be met by capital requirements that are specifically calculated for each individual Entity. It could also be met by capital requirements that apply under a standardised banding system, such as one that distinguishes between smaller and larger Entities based on a measure of size, nature, scale or complexity, provided that still reasonably reflects the overall risk to which *credit institutions* of that class are exposed. Capital requirements that apply to all institutions without any distinction would not be regarded as risk-weighted. For example if a Jurisdiction imposed a fixed minimum amount of capital for all Entities, without any variation (whether by a banding system that distinguishes between smaller and larger Entities based on a measure of size, or otherwise) according to the facts and circumstances of the relevant Entities, those capital adequacy requirements would not satisfy the "risk-weighted" requirement of subdivision (ii).

1708. Subdivision (iii) refers to the types of activities the Entity must perform. It refers to the provision of personal, commercial, or other loans or extensions of credit to unrelated customers. This covers a broad range of lending, and which would include financial leasing, credit card issuers, and credit card advances.

1709. However, two specific safeguards are provided in subdivision (iii), in addition to the safeguards of the licencing requirement in subdivision (i) and the capital requirement in subdivision (ii). The first is that the lending must be provided to another *regulated financial institution* (whether Group Entities of the same Group or not) or to unrelated customers (that is, persons that are not the Ultimate Parent Entity of the

Group of which the Entity is a member, or Entities whose Controlling Interest is owned by that Ultimate Parent Entity). The reference to lending to another *regulated financial institution* acknowledges that lending between such Entities is not unusual and may be the mechanism by which lending to external customers is made possible. For example, capital may be pooled centrally by lending amongst *regulated financial institutions*, to facilitate the extension of loans to the external customer. The reference to unrelated customers means persons that are not Group Entities. This is a stricter test than applies to any other category of *regulated financial institution*. It means that any intra-Group lending (other than to another *regulated financial institution*) will not qualify toward the 75 per cent threshold contained in subdivision (iv).

1710. The second safeguard is at the end of subdivision (iii), which is that the definition does not permit lending for the purpose of providing credit for purchases of the Group's own products (including goods or services, such as other financial products). This means that, for example, an automotive seller that provides consumer financing only to facilitate the consumer purchasing the Group's own cars would not qualify. In those cases, the purpose of providing credit would not be for the purchase of the Group's own products.

1711. Subdivision (iv) requires that the Entity's *total licensed reported revenue* attributable to those prescribed lending activities equals or exceeds 75 per cent of the Group Entity's *total reported revenue* during the Period. This is tested using the lending revenue as reported on the financial statement submitted to the regulator but excluding any such revenue attributable to Jurisdictions where the Entity is not licensed, as compared to the *total reported revenue* earned during the Period. If the income statement of the Entity is not submitted to the regulator, the figures are based on the revenue reported in the Entity's financial statements. In the context of a *credit institution*, the *total reported revenue* from the prescribed activities includes interest and lending fees. However, given that a *credit institution* will be primarily earning interest and related lending fees, but also be incurring its own interest and related fee expense, such Entities typically report revenue to the regulator net of interest and other related fee expenses. As such revenue net of interest and related fee expenses is the revenue figure that should be used for the numerator. The Entity's *total reported revenue* during the Period means the revenues from all activities. The denominator should also include those revenues net of the interest and related fee expenses.

Deposit

1712. The definition of *deposit* is relevant for the definition of *depository institution*. That definition requires that an Entity accept "deposits".

1713. The definition of *deposit* is broad. It means funds which are required to be repaid on demand or at the time agreed under the applicable legal and contractual conditions, with or without interest or a premium. The core feature is that the funds are required to be repaid, because the *deposit* represents a liability of the financial institution to the depositor.

1714. The reference to being repaid on demand means that the depositor can withdraw its money at any time. The fact that the ability to make such a withdrawal is subject to the physical availability of a withdrawal facility, such as an automatic teller machine or an in-person teller at a branch does not disqualify the funds from being repaid on demand.

1715. As an alternative to being repaid on demand, funds will still be treated as a *deposit* where the funds are required to be repaid at a time agreed under the applicable legal or contractual conditions. This accommodates cases where a *deposit* may be agreed by the depositor to be only available after a certain period of time, such as in the case of a certificate of *deposit* or fixed term *deposit*.

1716. It is common, but not universal, that in exchange for the *deposit*, the financial institution will pay the depositor an amount of interest. Whether this is a feature or not will not affect whether the funds qualify as a *deposit*.

1717. The meaning of the term *deposit* is not limited by reference to the nature of the customer. As such, the person making the *deposit* may be an unrelated member of the public, or may be another Entity within the Group, including other *regulated financial institutions* in the Group.

1718. In some Jurisdictions, *deposits* may be protected in full or in part by a government guarantee or insurance scheme. The presence of such protection is not required for the funds to meet the definition of *deposit*.

1719. The definition of *deposit* includes certain limitations which mean that certain payments are not treated as *deposits*, irrespective of whether they would otherwise meet the requirement to be repaid on demand or at the time set out in the legal or contractual terms. There are five types of such payments, all of which are not *deposits*. Those payments are:

- bonds;
- down-payments made by customers as part-payment of the purchase of a product;
- funds where the principal is not repayable at par (except for *deposits* made in local currency into an account of another currency where fluctuations in the par value are a result of currency fluctuations);
- payment made by way of security for the performance of a contract; or
- payments made by customers in connection with money transfer services.

1720. A bond is a financial instrument representing a debt-obligation of the issuer. It may be issued by a wide range of actors, including commercial business and governments. In exchange for the credit advanced, the bond instrument, the issuer agrees to repay the debt at a certain point in time, typically along with periodic interest payments. However, as with any loan, there is a risk that the issuer may not be able to repay the principal or interest, and the credit advanced to the issuer is not treated as a *deposit*.

1721. A down-payment made as part-payment for the purchase of a product (which may be a good or service) may take place in retail or commercial contexts. Instead of paying the purchase price in full in one transaction, the payments are made in instalments over time. The purchaser may have possession of the good (or access to the service) at the beginning of the arrangement or only on full payment of the purchase price. The purchaser may, however, be able to rescind the arrangement and may receive a return of its payments, in full or less transaction fees. The receipt of funds by the seller of the product is not treated as a *deposit*, even if the amount is ultimately returned to the person that made the payment.

1722. The case where funds are not repayable at par includes, for example, where the funds are deposited in exchange for another asset, which may be redeemed for the value it holds at that later redemption date. This includes a *deposit* of funds in exchange for assets such as crypto-currency or shares. Such a transaction is an investment which involves *financial risk* and there is no certainty that the original sum of money will be repaid at least at the original value and as such are not treated as *deposits*. However, an amount may generally be considered as being repayable at par if repayment of it is subject to the deduction of fees by the Entity.

1723. However, the limitation on the principal being repaid at par does not extend to the case where a *deposit* is made in local currency into an account of another currency and where the depositor's right to repayment is determined by the value of that other currency. In those cases, fluctuations in the par value are a result of currency fluctuations, as opposed to the amount deposited being put at risk. Such amounts can qualify as *deposits*.

1724. Payment made by way of security for the performance of a contract includes a payment made as collateral pursuant to a sale or lease of property, collateral for a financing arrangement such as a stock loan or repo, and funds placed in escrow to guarantee a legal undertaking. The funds may be held temporarily by an agent or a party to a transaction pending the completion of performance of the relevant transaction or obligation, or may be returned to the person that made the payment depending on the performance of the relevant obligations. The payment may also serve as security to cover a loss resulting from the non-performance of a contract. The payment, whether temporarily held or returned in full or in part to the person making the payment, is not treated as a *deposit*.

1725. Payments made by customers in connection with money transfer services include the sum being transferred to the recipient. The money transfer service provider would hold the funds temporarily, in the course of completing the transfer. This temporary holding of funds is not treated as a *deposit*.

Depository institution

1726. The term *depository institution* means a Group Entity that meets the licencing requirement in subdivision (i), the regulatory requirement in subdivision (ii), and the activities requirements in subdivisions (iii) and (iv).

1727. The licencing requirement in subdivision (i) means that the Entity must be authorised to carry on a banking business under the laws or regulations of a Jurisdiction where it does that business (or as permitted under EEA passporting or equivalence arrangements). This means that it must be legally permitted by the relevant supervisory authority to carry out the activities carried on in the ordinary course of a banking business, which would include those listed in subdivision (iii). The nomenclature of the licence may be something other than "banking"; for example, it may be referred to as *deposit-taking*.

1728. The regulation requirement in subdivision (ii) refers to being subject to capital adequacy requirements that reflect the Core Principles for Effective Banking Supervision as provided by the Basel Committee on Banking Supervision (the "Basel Core Principles"). The presence of the relevant requirements are tested by reference to the law or regulations of the Jurisdiction in which that Group Entity is established. Principle 16, which provides for capital adequacy, requires that: "The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards".

1729. The essence of this requirement is that the Entity is subject to capital adequacy requirements that take into account risks taken on and presented by the Entity. The risks that would typically be considered in this assessment include the potential loss absorbency of the instruments included in the bank's capital base, the appropriateness of risk weights as a proxy for the risk profile of its exposures, the adequacy of provisions and reserves to cover loss expected on its exposures and the quality of its risk management and controls. This requirement would therefore not be met in Jurisdictions that impose a fixed minimum amount of capital for all Entities, without any variation (whether by a banding system that distinguishes between smaller and larger Entities based on a measure of size, or otherwise) according to the facts and circumstances of the relevant Entities.

1730. Subdivision (iii) includes the activities requirement. This is that the Entity must accept *deposits* in the ordinary course of a banking or similar business. See above for discussion of the term “deposits.” This means there are two parts to the activities test, both of which must be satisfied: the acceptance of *deposits* (which is further combined with the condition in subdivision (iv)), and that such acceptance of *deposits* takes place in the ordinary course of a banking or similar business.

1731. An Entity is considered to be engaged in a “banking or similar business” if, in the ordinary course of its business with customers, it regularly engages in one or more of the following activities:

- a) makes personal, mortgage, industrial, or other loans or provides other extensions of credit;
- b) purchases, sells, discounts, or negotiates accounts receivable, instalment obligations, notes, drafts, checks, bills of exchange, acceptances, or other evidence of indebtedness;
- c) issues letters of credit and negotiates drafts drawn thereunder;
- d) provides trust or fiduciary services;
- e) finances foreign exchange transactions; or
- f) enters into, purchases, or disposes of finance leases or leased assets.

1732. It is not necessary that an Entity carry out all of those activities, nor is the Entity precluded from undertaking other activities. Undertaking one or more of these listed activities in the ordinary course of business is sufficient to be treated as being engaged in a banking or similar business.

1733. Subdivision (iv) requires that one of two further conditions is met. It is possible that an Entity might meet both conditions; but it is only necessary that one of them be demonstrated.

1734. Subdivision (iv)(A) provides that at least 20 per cent of the liabilities of the Entity consist of *deposits*, as at the balance sheet date for the Period. This condition is intended to ensure that the Entity accepts a meaningful volume of *deposits*, in practice, measured by way of a threshold of *deposits* taken. The condition should be measured using the balance sheet of the tested Entity for the Period. This test ensures that a regulated Entity that has a banking licence but does not actually accept *deposits* (for example, a consumer products financing service that is formally regulated as a bank) cannot qualify as a *depository institution*.

1735. Subdivision (iv)(B) sets out the alternative condition to the 20 per cent *deposit*-taking threshold test. This requirement is that at least 10 per cent of the liabilities of the Entity consist of *deposits*, as at the balance sheet date for the Period, and that the Entity has a specific relationship with the central bank. That relationship with the central bank requirement will be satisfied if the Entity can be required to post reserves with a central bank or comply with central bank reserve requirements, and that it has access to the central bank’s borrowing window or liquidity facilities.

1736. The test relating to posting reserves or complying with reserve requirements looks to whether an Entity could legally be required to post reserves or comply with such requirements, rather than whether it is in practice posting reserves or complying with reserve requirements. This is to ensure that an Entity could still be treated as having met the condition in cases when the requirement would only be imposed by the central bank in given cases, such as where a particular risk arises. Similarly, the requirement that the Entity has access to a central bank’s borrowing window or liquidity facilities focuses on the legal right to have such access, irrespective of whether particular terms or limitations would apply to such access.

1737. Where the Entity's reporting period aligns with the reporting period of the Consolidated Financial Statements, that is the Entity's balance sheet that should be used for the Period. However, if the Entity's reporting period does not align with the reporting period used in the Consolidated Financial Statements, the rule does not require that the Entity's balance sheet be adjusted to correspond to the Group's reporting period. In such cases, the Group should use the Entity's balance sheet that has the most overlap with the reporting period for the Consolidated Financial Statements. For example, if an Entity's reporting period ends on 31 March 2030 and the Group's reporting period ends on 31 December 2030, the Entity should use the balance sheet for the period 1 April 2030 – 31 March 2031 (reflecting a 275 day overlap). The additional day in leap years should be ignored when measuring the overlap period. This approach is adopted to ensure that for the purpose of assessing whether an Entity is a *regulated financial institution*, the financial statements that are used are those that are available to the regulator, rather than the adjusted statements as used for accounting consolidation purposes which the regulator may not review. Reliance on the Entity's balance sheet is only for the purpose of determining whether the Entity meets the definition of *regulated financial institution*. When calculating the *non-RFS adjusted revenues* and making other determinations as required by paragraph 2, the figures used must be those that are included in the Consolidated Financial Statements for the Period.

Financial assets

1738. This term is relevant for the definition of an *asset manager* and an *investment institution*. The definition is intended to be broad and is not exhaustive. It includes traditional investments in the financial markets, such as money, money market instruments, securities and investments associated with insurance, as well as derivative instruments.

1739. The term "security" includes, for example, a share of stock in a corporation; partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust; note, bond, debenture, or other debt instrument.

1740. The term "money" includes money held in any currency.

1741. Derivative instrument includes futures contracts, forward contracts, options, financial contracts for difference, swaps (including an interest rate swap), an index of such assets or a widely held or publicly traded partnership interest. It does not include crypto-assets and virtual assets, or derivatives with respect to such assets.

1742. The term *financial asset* is distinguished from physical assets, such as commodities and interests in *immovable property*. However, a physical commodity can be a *financial asset* if it is held as a hedge against a derivative in that commodity. Likewise, debt secured over *immovable property* (such as a mortgage-backed security) is a *financial asset*.

Financial risk

1743. This term is relevant to the definition of *insurance institution*. It is a type of risk that is distinguished from, and does not form part of the definition of, *insurance or reinsurance risk*.

1744. A *financial risk* is defined as the risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index. It can also mean the risk of a possible future change in any other variable, provided in the case of any other variable that the variable is not specific to a party to the contract.

1745. The term *financial risk* therefore covers two components: first it covers risks that are financial in nature, and in that respect is limited to the risks specifically identified. Second, it covers all other types of

risk (“other variables”) but only if those other risks are not specific to the counterparty to the contract. For example, if a contract covers the cost of the damage to a building of the counterparty on the occurrence of an earthquake, that variable (the earthquake risk) is one that is specific to the counterparty. As such, the risk is not a *financial risk*, and the arrangement can qualify as an *insurance contract*. On the other hand, if a person enters into a derivative in respect of earthquake risk in a city and pursuant to which payments are made to that person if an earthquake occurs in the city, that variable (the earthquake risk) is not specific to the party to the contract and as such it is a *financial risk*. The difference from an *insurance or reinsurance risk* is that a *financial risk* is one that is not dependent on the occurrence of an event to the insured person, but is financial in nature and external to the insured person.

1746. Given this specific definition, the exclusion of *financial risk* from the definition of *insurance or reinsurance risk* does not mean that *insurance contracts* related to financial matters are not treated as *insurance contracts*. For example, insurance policies that insure the insured person’s ability to make mortgage repayments is not a *financial risk* (but would be an insurance risk) as it is not one of the specified risks identified in the first limb of the definition (it therefore is an “other variable”) and it is specific to the policyholder (the mortgagor).

Group captive entity

1747. A *group captive entity* is explicitly deemed to not meet the definition of *asset manager, credit institution, depositary institution, insurance institution, investment institution, mixed financial institution, or regulated financial institution service entity*, irrespective of whether it might otherwise meet the requirements of such definitions. The term is referred to in the definition of *regulated financial institution*.

1748. A *group captive entity* means any Group Entity that carries on an insurance or reinsurance business, and for the Period 50 per cent or more of its *total reported revenue* is derived from Group Entities of the same Group that are not *asset managers, credit institutions, depositary institutions, insurance institutions, investment institutions, mixed financial institutions, or regulated financial institution service entities*. For example, both pure captive arrangements as well as fronting arrangements involving an unrelated *insurance institution* will count toward whether the entity is a *group captive entity*. This is tested for each Period.

1749. To test this condition for the Period, the numerator is the revenue (including the gross written premiums) derived from other Group Entities that do not qualify as *regulated financial institutions*. The denominator is *total reported revenue* of the group entity (also inclusive of the gross written premiums).

1750. This means that revenue derived from other Group entities that do qualify as *regulated financial institutions* will not increase the chance that the Entity is treated as a *group captive entity*. For example, if a Group Entity provides insurance or reinsurance to a Group Entity that is itself an *insurance institution*, then the revenue derived from such contracts does not count in the numerator, but will count in the denominator. This means that insurance provided as between *insurance institutions* in the same group will not increase the chance of an Entity being treated as a *group captive entity* and thereby being disqualified from the exclusion for regulated financial services.

Group treasury entity

1751. A *group treasury entity* is explicitly deemed not to meet the definition of *asset managers, credit institutions, depositary institutions, insurance institutions, investment institutions, mixed financial institutions, or regulated financial institution service entities*, irrespective of whether it might otherwise meet the requirements of such definitions. It is referred to in the definition of *regulated financial institution*.

1752. A *group treasury entity* is any Group Entity that provides treasury functions and for the Period 50 per cent or more of the *total reported revenue* of which is derived from Group Entities of the same Group that are not *regulated financial institutions*. This is tested for each Period.

1753. Treasury functions means the holding, lending and investing of funds to and for Group Entities in the same Group, as well as any associated services (such as managing liquidity, foreign exchange risk, intra-group payment processes, financial governance and risk management, and related analytics).

1754. To test this condition for the Period, the numerator is the revenue from treasury functions (including interest (net of interest expense), gross commissions and gross service fees) derived from other Group Entities that do not qualify as *asset managers, credit institutions, depositary institutions, insurance institutions, investment institutions, mixed financial institutions, or regulated financial institution service entities*. The denominator is *total reported revenue* of the group entity.

1755. The last part of the definition means that if a Group Entity provides services, such as holding *deposits*, making loans, or investing assets for a Group Entity that is itself a *regulated financial institution*, then the revenue derived from such services does not count in the numerator, but will count in the denominator. This means that such financial services provided as between *regulated financial institutions* in the same group will not increase the chance that an Entity is treated as a *group treasury entity* and thereby being disqualified from the exclusion for regulated financial services.

Insurance contract

1756. The definition of *insurance contract* is relevant for the definition of *insurance institution*. This is because subdivision (iii) of the definition of *insurance institution* tests whether the Entity derives a substantial proportion of its revenue from *insurance contracts* (as well as *annuity contracts* and *related investment revenue*).

1757. The definition of *insurance contract* draws on the definition used in accounting standards, with a view to ensuring that contracts that are treated as *insurance contracts* in the financial statements are similarly recognised for purposes of the Convention. It means a contract under which the issuer (the insurance company) accepts *insurance or reinsurance risk* from another party (the insured party) by agreeing to compensate that other party (or a party designed by that other party) if a specified uncertain future event adversely affects that other party. In essence, it is a contract to transfer the financial consequences of the risk of an event taking place from one person to the other, in exchange for the payment of a sum (which may be recurring or one-off).

1758. The requirement that the risk is one that is accepted by the issuer from the policyholder means that the risk must be one to which the policyholder was already exposed. If a contract only creates a risk, it will not be regarded as an *insurance contract*.

1759. The obligation to make a payment under the contract must be tied to an uncertain future event. Uncertainty (or risk) is the essence of an *insurance contract*. Accordingly, at least one of the following must be uncertain at the inception of an *insurance contract*:

- the probability of an insured event occurring;
- when the insured event will occur; or
- how much the policyholder will need to pay if the insured event occurs.

1760. Further, the uncertain future event must adversely affect the policyholder. If a contract requires a payment on the occurrence of a specified uncertain future event, but does not require an adverse effect on the policyholder as a precondition for the payment the contract is not an *insurance contract* even if the holder uses it to mitigate an underlying risk exposure. For example, an investor might use a derivative to hedge a risk that is correlated with the cash flows from an asset they hold. The derivative is not an *insurance contract* because the payment is not conditional on whether the holder is adversely affected by a reduction in the cash flows from the asset.

1761. An *insurance contract* also includes a contract under which a participant agrees to contribute to a common fund providing for mutual financial benefits payable to the participants or their beneficiaries upon the occurrence of a specified uncertain future event.

Insurance institution

1762. The term *insurance institution* means a Group Entity that meets the licencing requirement in subdivision (i), the regulatory requirement in subdivision (ii), and the activities requirements in subdivision (iii).

1763. The licencing requirement in subdivision (i) means that the Entity must be authorised to carry on an insurance or reinsurance business under the laws or regulations of a Jurisdiction where it does business (or as permitted under passporting or equivalence arrangements). This means that it must be legally permitted by the relevant supervisory authority to carry out the activities typically carried out by an insurance firm, i.e., those listed in subdivision (iii).

1764. The regulation requirement in subdivision (ii) refers to being subject to solvency standards that incorporate a risk-based capital measure. The presence of the relevant requirements are tested by reference to the law or regulations of the Jurisdiction in which that Group Entity is established.

1765. There is not one global set of regulatory standards applicable to insurance, but the principles are generally consistent with one another. For example, the International Association of Insurance Supervisors (IAIS) Insurance Core Principle 17 provides: “The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.”

1766. The essence of this requirement is that it is subject to capital adequacy requirements for solvency purposes that take into account risks taken on. This means, as explained by the IAIS in its Commentary on Principle 17, for example, that the assessment of the capital requirements “take account of the nature and materiality of the risks insurers face generally and, to the extent practicable, should also reflect the nature, scale and complexity of the risks of the particular insurer.” This could be met by capital requirements that are specifically calculated for each individual entity. It could also be met by capital requirements that apply under a standardised banding system, such as one that distinguishes between smaller and larger entities based on a measure of size, nature, scale or complexity, provided that still reasonably reflected the overall risk to which insurers of that class are exposed. This requirement would therefore not be met in Jurisdictions that impose a fixed minimum amount of capital for all firms, without any variation according to facts and circumstances of the relevant Entities.

1767. Subdivision (iii) includes the activities requirement. There are two alternative ways that an Entity could meet this part of the test: a revenue test and an assets test. It is possible that an Entity might meet both conditions; but it is only necessary that one of them be demonstrated.

1768. The revenue test provided in subdivision (iii) requires that the *total licensed reported revenue* (which must include the gross written premiums even if the Entity reports on a net basis) of the Entity that arises from all *insurance contracts* and *annuity contracts* written by the Entity pursuant to the licence referenced in subdivision (i), and *related investment revenue* for the Period equals or exceeds 75 per cent of *total reported revenue* (which also must include the gross written premiums even if the Entity reports on a net basis) for such Period. Each of the terms “insurance contracts”, “annuity contracts”, and “related investment income” are defined in the Convention.

1769. The 75 per cent threshold is tested by identifying the revenue described above, as compared to the *total reported revenue* earned during the Period. This is tested using the gross insurance revenue as described above as reported on the financial statement submitted to the regulator but excluding any such revenue attributable to Jurisdictions where the Entity is not licensed, as compared to the *total reported revenue* earned during the Period. If the income statement of the Entity is not submitted to the regulator, the figures are based on the revenue reported in the Entity’s financial statements (and, where relevant, the financial statements of any other Entity that receives *related investment revenue*). In the context of an *insurance institution*, the relevant revenue from the prescribed activities includes gross premiums, ceding commission, and *related investment revenue* and this is the figure used in the numerator for this test. The denominator is the total revenue from all activities (which must also include gross premiums, ceding commissions and *related investment revenue*).

1770. With respect to the assets test in subdivision (iii), an Entity can meet the test where the aggregate value of the assets held to manage risk associated with *insurance contracts* and *annuity contracts* equals or exceeds 75 per cent of total gross assets as at the balance sheet date for the Period. The net book value as reported in the financial statements is used for this purpose.

1771. This reflects that assets may be held for the purpose of ensuring the *insurance institution* can pay claims when insured events occur, and is a core part of insurance business. Examples of assets held to manage risk associated with *insurance contracts* and *annuity contracts* include shares in a subsidiary that only undertakes investments for the purpose of providing funds to cover claims, as well as *financial assets* held by the *insurance institution* directly for the same purpose.

1772. The tests in subdivision (iii) mean that an Entity such as an insurance broker or insurance manager would not meet the definition, as they do not issue *insurance contracts*, nor do they hold funds for the purpose of meeting the claims of an insurer; rather, they earn service fees for activities that are adjacent to *insurance institutions*.

1773. Where the Entity’s reporting period aligns with the reporting period of the Consolidated Financial Statements, that is the balance sheet that should be used for the Period. However, if the Entity’s reporting period does not align with the reporting period used in the Consolidated Financial Statements, the rule does not require that the Entity’s balance sheet be adjusted to correspond to the Group’s reporting period. In such cases, the Group should use the Entity’s balance sheet that has the most overlap with the reporting period with the reporting period for the Consolidated Financial Statements. For example, if an Entity’s reporting period ends on 31 March 2030 and the Group’s reporting period ends on 31 December 2030, the Entity should use the balance sheet for the period 1 April 2030 – 31 March 2031 (reflecting a 275 day overlap). The additional day in leap years should be ignored when measuring the overlap period. This approach is adopted to ensure that for the purpose of assessing whether an Entity is a *regulated financial institution*, the financial statements that are used are those that are available to the regulator, rather than the adjusted statements as used for accounting consolidation purposes which the regulator may not review. Reliance on the Entity’s balance sheet is only for the purpose of determining whether the Entity meets the definition of *regulated financial institution*. When calculating the *non-RFS adjusted revenues*

and making other determinations as required by paragraph 2, the figures used must be those that are included in the Consolidated Financial Statements for the Period.

Insurance or reinsurance risk

1774. The definition of *insurance or reinsurance risk* is relevant to the definition of an *insurance institution* and an *insurance contract*. An *insurance contract* (from which an *insurance institution* derives revenue) is one which involves the issuer of the contract accepting *insurance or reinsurance risk* in return for a payment.

1775. An *insurance or reinsurance risk* means a risk other than a *financial risk*, which is transferred from the holder of a contract to the issuer of the contract. The type of risk is broad, and can be any type of risk that is transferred to the issuer, other than a *financial risk*.

1776. A non-exhaustive list of types of risk include mortality, morbidity, accident, liability, longevity, cyber, or property loss risk.

Investment institution

1777. The term *investment institution* means a Group Entity that meets the licencing requirement in subdivision (i), the regulatory requirement in subdivision (ii), and the activities requirements in subdivision (iii).

1778. The licencing requirement in subdivision (i) means that the Entity must be authorised to carry on a broker dealer, custodial, investment firm or investment banking business. This language is non-exhaustive, to recognise that different terms are used in different Jurisdictions to refer to these kinds of institutions. It also recognises that regulators can issue licences to do different kinds of activities, which might not always cover every activity listed in subdivision (iii). For this reason, subdivision (i) also refers to a licence to carry out one or more activities in subdivision (iii), without a requirement that the licence must name all of those activities.

1779. The licence must be issued under the laws or regulations of a Jurisdiction where it does business (or as permitted under EEA passporting or equivalence arrangements). This means that it must be legally permitted by the relevant supervisory authority to carry out the activities typically carried out by an *investment institution*, which would include those listed in subdivision (iii).

1780. The regulation requirement in subdivision (ii) provides two types of capital regulation that may be applicable, recognising that *investment institutions* in some Jurisdictions may be regulated in a similar way to a bank, and in other Jurisdictions a different regulatory regime may apply. As such, subdivision (ii) refers to the capital adequacy requirements that apply for banks under the Basel Core Principles and as referenced for *depository institutions*; or, alternatively, it refers to capital adequacy requirements that reflect the Objectives and Principles of Securities Regulation and the Implementing Methodology published by the International Organisation of Securities Commissions (IOSCO). An Entity need not meet both requirements, but only the one that is relevant in its regulatory context. The presence of the relevant requirements are tested by reference to the law or regulations of the jurisdiction in which that Group Entity is established.

1781. Principle 16 of the Basel Core Principles is referred to above in connection with the commentary on *depository institutions*. The relevant IOSCO Principle is Principle 30, which applies to market intermediaries. They are described by IOSCO to generally include institutions who are in the business of managing individual portfolios, executing orders and dealing in, or distributing, securities, but under local law may also include receiving and transmitting orders, proprietary trading/dealing on own account,

providing advice regarding the value of securities or the advisability of investing in, purchasing, or selling securities, securities underwriting, or placing of financial instruments without a firm commitment basis. Principle 30 of the IOSCO principles, which provides for capital adequacy requirements for market intermediaries, provides that: "There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake."

1782. As such, the capital requirements that apply to *investment institutions* are the same as those that apply to *depository institutions*, or market intermediaries as discussed under *asset managers*. The essence of this requirement, under both Basel Core Principle 16 and IOSCO Principle 30, is that it is subject to capital adequacy requirements that take into account risks taken on and presented by the Entity. The risk under Basel that would typically be considered in this assessment include (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. The risks that would typically be considered under IOSCO would include market, credit, liquidity and operational risks, the amount of which is related to the nature of the risks and the amount of business, the ability to absorb losses in the event of an adverse market event, and the ability to conduct an orderly wind down. Notwithstanding different language and methodologies, the key high-level concepts are similar.

1783. Whether regulated under Basel Core Principles or IOSCO, this could be met by capital requirements that are specifically calculated with respect to that institution. It could also be met by capital requirements that apply under a standardised banding system, such as one that distinguishes between smaller and larger entities based on a measure of size, nature, scale or complexity, provided that still reasonably reflected the overall risk to which *investment institutions* of that class are exposed. This requirement would therefore not be met in Jurisdictions that impose a fixed minimum amount of capital for all Entities, without any variation (whether by a banding system that distinguishes between smaller and larger entities based on a measure of size, or otherwise) according to the facts and circumstances of individual Entities.

1784. Subdivision (iii) includes the activities requirement. It provides that the Entity's *total licensed reported revenue* attributable to one or more of the prescribed activities in subdivision (iii) (that is, excluding any such revenue attributable to Jurisdictions where the Entity is not licensed) for the Period equals or exceeds 75 per cent of the Group Entity's *total reported revenue* for such Period. This is tested using the overall results as reported on the income statement submitted to the regulator. If the income statement of the Entity is not submitted to the regulator, the figures are based on the revenue reported in the Entity's financial statements. In the context of an *investment institution*, similar to a *credit institution*, the *investment institution* will also be incurring its own interest and related fee expense. Such Entities typically report revenue to the regulator net of interest and other related fee expenses. As such revenue net of interest and related fee expenses is the revenue figure that should be used in the numerator. The Entity's *total reported revenue* during the Period means the revenues from all activities. The denominator should also include those revenues net of the interest and related fee expenses. There is no requirement that the revenue be earned from third parties, and revenue earned from other *regulated financial institutions* can count toward the 75 per cent threshold.

1785. The prescribed activities listed in subdivision (iii) are:

- i) dealing, broking, clearing or trading in *financial assets* for own account or for account of customers; and/ or
- ii) holding securities in inventory; and/ or

- iii) hedging transactions; and/ or
- iv) securities lending and sale and repurchase agreements in respect of *financial assets*; and/ or
- v) participating in placing and underwriting, mergers and acquisitions, syndication, securitisation and securities issues and providing financial services related to such activities; and/ or
- vi) holding, safekeeping, transferring, controlling, administering or distributing *financial assets* for the account of other persons; and/ or
- vii) providing investment advice in support of the activities identified in subdivisions (i) through (vi) and performed by the Group Entity.

1786. These activities are intended to cover a broad range of activities in connection with investments, whether carried out on the Entity's own account (i.e. as principal), or carried out on behalf of a customer (i.e. as agent). Some of the listed activities in turn refer to *financial assets*, which is a defined term.

1787. The reference to financial services in item (v) includes advice to undertakings on capital structure, industrial strategy and related matters; advice and services relating to mergers, restructuring, the purchase or disposal of undertakings; investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments; and services related to underwriting.

1788. The reference to investment advice in item (vii) is limited to the advice given in the course of the Entity being providing the services listed in items (i) – (vi). For example, it would include advice given on the types of *financial asset* to be held in custody by the Entity, or on securities loans to be executed by the Entity; but it would not include consulting or legal advice where the Entity did not perform the underlying transaction.

1789. In the context of an *investment institution*, the *total reported revenue* from the prescribed activities includes revenue from custody, account maintenance, and transfer fees; commissions and fees earned from executing and pricing securities transactions with respect to *financial assets*; income earned from extending credit to customers with respect to *financial assets* held in custody (or acquired through such extension of credit); income earned on the bid-ask spread; gains from hedging activities; interest income and equivalent from securities lending and repurchase agreements; fees for relevant services including fees for providing financial advice with respect to the foregoing services performed by the Entity; and fees for clearance and settlement services.

Mixed financial institution

1790. Some financial institutions may be conducting a mix of qualifying activities as set out in subdivision (iii) of each of the definitions of an *asset manager*, *credit institution*, *insurance institution*, or *investment institution*. These activities are referred to as "relevant activities" in the definition. This would have to be permitted by the relevant licencing condition, and is likely to take place where there is a commercial overlap in the types of activity, such as an institution engaged in both asset management and acting as custodian of *financial assets*. In such cases, it is possible that the Entity might not meet the 75 per cent *total licensed reported revenue* test pertaining to only one category; but it may be able to do so on aggregate when those activities are combined across categories.

1791. The definition of a *mixed financial institution* provides for this situation, meaning that such an Entity would not be disqualified from being a *regulated financial institution*, provided that the four conditions in the definition are met, as follows.

1792. The definition requires that the Entity must be licenced as an *asset manager*, *credit institution*, *insurance institution*, or an *investment institution*. It then also requires that the Entity must satisfy the regulatory requirements that apply under the definition of the type of financial institution for which the Entity has its licence. For example, if the Entity is licenced as an *investment institution*, then it must meet the capital requirements as set out under the definition of an *investment institution*.

1793. The definition is applicable only when the Entity otherwise does not meet the relevant *total licensed reported revenue* threshold as set out under the definition of an *asset manager*, *credit institution*, *insurance institution*, or an *investment institution*, as relevant.

1794. The definition also provides that the Entity could still meet the definition of a *regulated financial institution* if it can meet the 75 per cent *total licensed reported revenue* test for the Period in the aggregate by combining the revenue from different relevant activities that it undertakes but only in Jurisdictions where it is licensed. The numerator for this test is the *total licensed reported revenue* from the activities listed in subdivision (iii) of the definitions of an *asset manager*, *credit institution*, *insurance institution*, or an *investment institution* (as relevant and as discussed in each of those definitions) carried on in Jurisdictions where the Entity is licensed, and the denominator is the *total reported revenue* from all activities. This is tested using the overall results as reported on the income statement submitted to the regulator. If the income statement of the Entity is not submitted to the regulator, the figures are based on the revenue reported in the Entity's financial statements.

Regulated financial institution service entity

1795. Certain entities may also qualify as a *regulated financial institution*, notwithstanding the fact that they are not themselves subject to prudential regulation.

1796. This category of a *regulated financial institution* service entity applies in limited cases only where certain service entities perform activities that are integral to a Group's ability to perform regulated financial services, such as holding *immovable property* for the group, or employing and paying staff. Though these activities may be housed in an unregulated entity, for example because of requirements imposed by the regulator as part of recovery and resolution planning or to more efficiently manage administration of back-office functions, they remain integral to the group's performance of regulated financial services.

1797. There are three requirements, all of which must be met, for an Entity to be a *regulated financial institution service entity*.

1798. Subdivision (i) is an ownership test. That is that at least 95 per cent of the Group Entity is owned (directly or indirectly) by an Ultimate Parent Entity of a Group that is an *asset manager*, *credit institution*, *depository institution*, *insurance institution*, *investment institution* or *mixed financial institution* (other than a *group treasury entity* or a *group captive entity*, and not another *regulated financial institution service entity*), or at least 95 per cent of the Entity is owned by an Ultimate Parent Entity of a Group that is not itself a *regulated financial institution* but owns (directly or indirectly) 95 per cent of another *regulated financial institution* (other than a *regulated financial institution service entity*). That means that an Entity will only meet the definition of *regulated financial institution service entity* where one or more Group Entities meet the definition of an *asset manager*, *credit institution*, *depository institution*, *insurance institution*, *investment institution* or a *mixed financial institution*. The ownership is measured by value. The value of the Entity refers to the total value of the ownership interests issued by the Entity, and not the market value. For example, in the case of shares, it refers to the value of the issued share capital. The assessment of the value should be made as of the date of the most recent change in the Entity's relative ownership interests in the Entity and should take into account the value of all the ownership interests held by the Entity.

1799. Subdivision (ii) requires that the *total reported revenue* attributable to performing administrative support services for the benefit of one or more other *regulated financial institutions* (other than a *regulated financial institution service entity*) of the same Group equals or exceeds 75 per cent of the Group Entity's *total reported revenue* during the Period. The term *total licensed reported revenue* is not used in this context, given that such entities may not be specifically licensed.

1800. There are three elements to this requirement in subdivision (ii).

1801. First, the entity must be carrying out "administrative support services". This is a narrow category, focussing on administrative services that would typically be remunerated on a cost-plus basis, such as providing payroll functions for employees that perform services for the *regulated financial institution*, holding real estate that is invested in or used by the *regulated financial institution* as part of its business, information technology services, and performing other back office and procurement functions. It would not include the provision of fintech or payment processing services.

1802. Second, the entity must be carrying out those administrative support services for Group Entities of the same Group, which are themselves *regulated financial institutions* (excluding another *regulated financial institution service entity*). This means that revenue from providing administrative support services for *regulated financial institutions* of another Group would not count toward the 75 per cent threshold (discussed below). It also means that revenue from providing administrative support services for Group Entities that do not meet one of the definitions of *regulated financial institution* or that are other *regulated financial institution service entities* would not count toward the 75 per cent threshold.

1803. Third, the entity must be predominantly carrying out such administrative support services, as measured by the fact that at least 75 per cent of its revenue is attributable to such activities in the Period. This is measured as a fraction, where the numerator is the *total reported revenue* from administrative support services provided to other *regulated financial institutions* of the same group, and the denominator is *total reported revenue* from all activities.

1804. The final requirement in subdivision (iii) of the definition of *regulated financial institution service entity* is that those administrative support services are necessary to the carrying out of the activities of the *regulated financial institution(s)* (other than *regulated financial institution service entities*) that it serves. The purpose of this test is to ensure a direct and close connection between the activities of the *regulated financial institution service entity* and that of the *regulated financial institutions* it serves, such that the *regulated financial institution service entity* could be said to be a functional extension of the institution. In other words, the services are of a type that they would otherwise be performed by the *regulated financial institution* itself, given that they are typically back-office functions necessary to the operational functions of that institution; but they are (for regulatory or commercial reasons) housed in a separate entity.

Related investment revenue

1805. *Related investment revenue* is relevant to the term *insurance institution*. It is included in subdivision (iii) of that definition as part of the revenue that qualifies toward the 75 per cent threshold.

1806. In order to be *related investment revenue*, the revenue must be investment income. Investment income means passive income such as dividends, interest and rents and gains from dispositions from assets that produce such income. It does not include revenue from conducting a trade or business (other than the trade or business of investing). It must further be from assets associated with *insurance contracts* and *annuity contracts*. This means all financial investments necessary to allow the insurer or reinsurer to cover all of their insurance liabilities. This will be the case where those investments are considered by the regulator in assessing the *insurance institution's* risk and / or capital.

1807. The investment income may be earned directly by the *insurance institution*, for example, where it directly owns bonds to support its ability to pay the insurance claims.

1808. It may also be earned indirectly, through a separate subsidiary. Investment income earned through a separate subsidiary will count as *total reported revenue* of the *insurance institution* (and therefore count towards its 75 per cent threshold test), provided that the following conditions are met:

- The subsidiary is another Group Entity;
- The subsidiary holds assets or invests funds for the benefit of other Group Entities; and
- Such assets or funds, or the ownership interests in that subsidiary Group Entity, are reflected in the calculations undertaken when assessing the solvency (referenced in subdivision (ii) of the definition of an *insurance institution*) of the *insurance institution*.

1809. The third requirement means that in order to qualify, the regulator must treat the revenue, or the value of the ownership interest in the subsidiary, as counting toward the capital requirements for the *insurance institution*. The flexibility to count this by reference to the revenues themselves or to the ownership interests in the subsidiary accounts for different approaches that regulators may take in calculating capital requirements (that is, whether to look through to the revenue, or value the subsidiary as an asset itself in proportion to the ownership interest). Provided that the regulator does in fact take into account the income or value of the subsidiary in calculating the *insurance institution's* capital, then the condition is met.

1810. However, not all revenue of such a subsidiary is taken into account. The amount of the revenue that is treated as *related investment revenue* for the purpose of applying the condition in subdivision (iii) of the definition of *insurance institution* is the amount that is investment revenue of the subsidiary pro-rated by reference to the *insurance institution's* ownership share in the subsidiary. The ownership is measured by value. The value of the subsidiary refers to the total value of the ownership interests issued by the subsidiary, and not the market value. For example, in the case of shares, it refers to the value of the issued share capital. The assessment of the value should be made as of the date of the most recent change in the *insurance institution's* relative ownership interests in the subsidiary and should take into account the value of all the ownership interests held by the *insurance institution*.

1811. For example, in Period 1, the *insurance institution* directly owns 60 per cent of the value in a subsidiary that is a Group Entity. The subsidiary earns EUR 100 of investment revenue. EUR 60 of that revenue is counted as *related investment revenue*.

1812. For example, in Period 1, the *insurance institution* owns directly and indirectly 60 per cent of the vote and value of the subsidiary. The subsidiary earns EUR 60 of investment revenue and EUR 40 of other revenue. EUR 36 of that investment revenue is counted as *related investment revenue*.

1813. In order to prevent double counting, any such revenue attributed as *related investment revenue* of the *insurance institution* and the corresponding profit (or loss) must be deducted from the subsidiary's revenue and profit (or loss) respectively for the purpose of calculating the *non-RFS adjusted revenues* and *non-RFS adjusted profit before tax*. This is reflected in the definition of *non-RFS adjusted revenues* and *non-RFS expenses* (which refer to *related investment revenue* where relevant), which are in turn used in the definition of *non-RFS financial accounting profit (or loss)*.

Total licensed reported revenue

1814. The definition of *total licensed reported revenue* is relevant to the revenue threshold test in each of the definitions of *asset manager*, *credit institution*, *insurance institution* and *investment institution*. The purpose of the revenue threshold test in each case is to ensure that the Entity is doing enough activities that are regulated to qualify for the exclusion. Revenue from such activities should only be capable of satisfying the revenue threshold test if they are also undertaken under a licence described in condition (i) of the relevant definition. This includes activities carried on in one Jurisdiction pursuant to a licence issued by another Jurisdiction (for example under the EEA passporting regime or under equivalence arrangements).

1815. This definition ensures that only revenue from the identified activities undertaken under a licence can satisfy the revenue threshold test (whether that licence is issued by the tested Jurisdiction or by another Jurisdiction but extends to cover the activities in the tested Jurisdiction whether under the EEA passporting regime or under equivalence arrangements). To achieve this the definition excludes revenue attributable to Jurisdictions where the licensing condition is not satisfied.

1816. This is necessary because the rules otherwise assess whether the Entity as a whole earns sufficient revenue from the identified activities, rather than assessing whether those activities are also carried out pursuant to a licence. This definition of *total licensed reported revenue* provides a mechanism to still treat an Entity as able to meet the definition of the relevant *regulated financial institution*, even if not all of its activities are undertaken pursuant to a licence, provided it otherwise meets the revenue threshold test.

Total reported revenue

1817. Each of the definitions of *regulated financial institution* (other than *depository institution*) use a threshold test based on *total reported revenue* in order to establish whether the Entity is engaged in the relevant financial services. The purpose is to identify whether an Entity qualifies as a *regulated financial institution*. If so, there is a separate question of applying the *non-RFS adjusted revenue* test in Article 3, as amended by Annex C Section 2 which looks not to the *total reported revenue* of each Entity, but to the revenue that is reported in the revenue line in the Group's Consolidated Financial Statements. In other words, after it has been established that an Entity is a *regulated financial institution*, including by reference to the *total reported revenue* test using the local Entity financial statements, the Group would then subtract that Entity's revenue from the revenue of the Group to the extent it is reflected in the Consolidated Financial Statements.

1818. There are two key concepts involved in the term "total reported revenue".

1819. The first is that it is a measure of revenue which is understood as a gross amount (other than in limited cases explained below), and not profit. This is because the purpose is to identify Entities that are meaningfully engaged in the activity, and not whether and to what extent they are commercially successful in generating a profit. This means, for example, in the case of an *insurance institution* it would look to the gross premiums written without offsetting for premiums ceded, claims paid, or other expenses.

1820. However, the term "total reported revenue" is used to distinguish it from the defined term "revenue". That is because the term revenue broadly means consolidated revenue after removing the revenue in connection with the regulated financial services exclusion. The definition should cover all of the revenues of the Entity (that is, the legal Entity which includes any branches), and not just those attributable to the head office.

1821. In most cases, the revenue figure is the gross figure. It may be referred to as revenue or gross income or possibly turnover in the context of a *local entity's* reporting. However, there are certain cases where it is standard practice to report items net of certain expenses. This is the case for *depository institutions*, *credit institutions* and *investment institutions* typically report interest income and investment income net of interest expense and related fees. In such cases, this netted amount is the figure that should be used for *total reported revenue*. However, for *insurance institutions*, the accounting practice varies and as such in the case of an *insurance institution*, *total reported revenues* includes the gross premiums written (even if premiums are reported in the accounts on a net basis) without offsetting for premiums ceded, claims paid, or other expenses.

1822. The second key concept in the definition is that it first looks to the financial statements as reported to the relevant regulator. This ensures that robust and reliable data is used, given that the information is subject to the scrutiny of the financial services regulator. However, there may be cases where an Entity is not required to submit financial statements to the regulator. In such cases, the Entity would use its financial statements.

1823. Where the Entity's reporting period aligns with the reporting period of the Consolidated Financial Statements, those are the financial statements that should be used for the Period. However, if the Entity's reporting period does not align with the reporting period used in the Consolidated Financial Statements, the rule does not require that the Entity's financial statements be adjusted to correspond to the Group's reporting period. In such cases, the Group should use the Entity's financial statements that has the most overlap with the reporting period for the Consolidated Financial Statements. For example, if an Entity's reporting period ends on 31 March 2030 and the Group's reporting period ends on 31 December 2030, the Entity should use the financial statements for the period 1 April 2030 – 31 March 2031 (reflecting a 275 day overlap). The additional day in leap years should be ignored when measuring the overlap period. This approach is adopted to ensure that for the purpose of assessing whether an Entity is a *regulated financial institution*, the financial statements that are used are those that are available to the regulator, rather than the adjusted statements as used for accounting consolidation purposes which the regulator may not review. Reliance on the Entity's financial statements is only for the purpose of determining whether the Entity meets the definition of *regulated financial institution*. When calculating the *non-RFS adjusted revenues* and making other determinations as required by paragraph 2, the figures used must be those that are included in the Consolidated Financial Statements for the Period.

Paragraph 4

1824. Paragraph 4 applies to a Covered Group which contained one or more *regulated financial institutions* in a prior Period, but did not include any *regulated financial institutions* in the Period. Paragraph 4 makes adjustments to the calculation of amounts in prior Periods to exclude amounts relating to *regulated financial institutions* where those amounts are relevant to the Period. This is necessary to ensure that the correct calculations are applied in the current Period, where they would be affected by the historical application of the rules for a Group which contained one or more *regulated financial institutions* in a prior Period.

1825. The effect of paragraph 4 is that for the purpose of applying the averaging rules in the current Period, the results of applying the exclusion with respect to *regulated financial institutions* in the prior Period continue to affect the current calculations. In addition, it ensures that the losses incurred in the prior Period related to *regulated financial institutions* cannot be used to offset against Amount A in the current Period.

1826. Subparagraph (a) replaces the term "pre-tax profit margin" in Article 3(2)(a) with the term "non-RFS pre-tax profit margin". This excludes amounts derived from *regulated financial institutions* from the

calculation of the *pre-tax profit margin* in the Periods immediately preceding the Period. The term “non-RFS pre-tax profit margin” is defined in paragraph 2(b).

1827. Subparagraph (b) substitutes the term “non-RFS adjusted profit before tax” for the term Adjusted Profit Before Tax and subparagraph (c) replaces the term “Adjusted Revenues” with the term “non-RFS adjusted revenues” in Article 3(2)(b). These adjustments exclude amounts derived from a *regulated financial institution* from the calculation in Article 3(2)(b). The term “non-RFS adjusted profit before tax” is defined in paragraph 2(c) and the term “non-RFS adjusted revenues” is defined in paragraph 2(a).

1828. Subparagraph (d) replaces the term “relevant net losses” with “non-RFS relevant net losses”. This ensures that losses in prior Periods that derive from a *regulated financial institution* are not deducted from the Adjusted Profit Before Tax in the Period. The term “non-RFS relevant net losses” is defined in paragraph 2(h).

Section 3 – Application of this Convention to a qualifying extractives group

Paragraph 1

Application of the Convention to a qualifying extractives group

1829. Paragraph 1 replaces the terms used in the Convention for the purpose of applying the Convention to a Group that would be a Covered group for a Period under Article 3 and that is a *qualifying extractives group*. There are two prerequisites for applying the extractives exclusion. First, that the Group must first have met the scope thresholds that apply to all Groups, as set out in Article 3. If a Group is not in scope under the ordinary scope thresholds, there is no cause for applying the extractives exclusion. Second, that the Group is a *qualifying extractives group* (defined in Section 3(3)).

1830. The result of paragraph 1 is that a Group is only a Covered Group if that Group has both *non-extractives adjusted revenues* greater than EUR 20 billion and a *non-extractives pre-tax profit margin* greater than 10 per cent in that Period. The effect of paragraph 1 is to remove the revenue and profit (or loss) of the Group that derives from extractives and to apply the ordinary scope thresholds found in Article 3. In the same way, paragraph 1 provides for the application of the ordinary rule on *unused losses*, but only with respect to losses incurred in connection with non-extractives.

1831. The combined effect of the provisions Article 3 is that the exclusion operates in the following way.

1832. First, if the Group does meet the relevant thresholds in Article 3, then determine whether the Group is a *qualifying extractives group*. To do so, use the definitions provided in Section 3 (3). This is a ‘yes or no’ question. The purpose of this enquiry is not to quantify the relative size of the extractives business vis-à-vis any other parts of the Group, but to determine whether the Group is eligible for the exclusion.

1833. If the answer is ‘yes’ (i.e. the Group is a *qualifying extractives group*), then Article 3(5) requires that the Group must apply the rules in the Annex C Section 3. The effect of the rules in Section 3 are that the *extractives revenue* and profits are excluded, and the Group can only be in scope if it meets both of the thresholds in Article 3(1)(2) as reapplied to the remaining *non-extractives revenue* and profits.

1834. Second, apply the *non-extractives adjusted revenue* test (see Section 3(1)(b) and (2)(o)). The definition of *non-extractives adjusted revenues* requires the following. First, that the Group identify the *extractives revenues* that are reported in the Adjusted Revenues (i.e. third party revenues). *Extractives*

revenues are defined in Section 3(3). The Group would then deduct those *extractives revenues* from the Adjusted Revenues. After that deduction, the Group would test whether the amount of remaining revenues is above EUR 20 billion. If not, then the Group is not a Covered Group because it has not met the non-extractives revenue test. Such a Group would not continue with the following steps. Simplification options apply to this part of the analysis, contained in Annex E Section 2.

1835. Third, if the Covered Group does have *non-extractives adjusted revenues* in excess of EUR 20 billion, the Group would then determine whether the *non-extractives pre-tax profit margin* exceeds 10 per cent (see Section 3(1)(a) and 2((n)). This definition of *non-extractives pre-tax profit margin* in turn contains the defined term *non-extractives adjusted profit before tax*, which in turn draws on other related terms such as *non-extractives financial accounting profit (or loss)*. These terms together provide the details of the methodology for making the determination of the *non-extractives pre-tax profit margin*. This methodology isolates the extractives portion of the Group and treats the remaining portion of the Group as if it was a separate business. As profits or losses relating to the Group's extractives business are disregarded (and are not available for carry-forward), the rules for determining the *non-extractives pre-tax profit margin* and therefore whether the Group is in the scope of the Convention still apply even if the Group's extractives business made a loss.

1836. The methodology starts with identifying the *non-extractives financial accounting profit (or loss)* (see Section 3(2)(z)).

1837. It includes two possible approaches. One is the disclosed segment approach (Section 3(2)(z)(i)), and in cases where the disclosed segment approach is not used, the entity approach is used (Section 3(2)(z)(ii)). A Group that reports *disclosed segments*, can elect to use either the disclosed segment approach or the entity approach. A Group that does not report *disclosed segments* would use the entity approach. The definition of *non-extractives pre-tax profit margin* also contains the two alternatives, and a group must use either the disclosed segment approach or the entity approach consistently when it applies all of the rules in Annex C for a Period.

1838. The disclosed segment approach starts with the Financial Accounting Profit (or Loss) reported in the Consolidated Financial Statements for the Group, and then makes a series of adjustments to that. It uses administrative simplifications, based on a 'predominance test.' This predominance test applies only for the purpose of simplifying the calculations for a Group that is a *qualifying extractives group*, to ensure the profits from extractives are appropriately, but as simply as possible, excluded from the scope of the Convention.

1839. The disclosed segment approach applies in cumulative steps, which are described in general terms as follows. More specific explanation is included below in respect of each of the relevant defined terms.

- The first deduction is to exclude in full segments that are predominantly reporting *extractives revenue* ("extractives segment", see Section 3(2)(d)), and add back revenue and costs reported in the other *disclosed segments* from transactions with the *extractives segment*.
- From that reduced figure, the next deduction is to remove *extractives profits* as well as certain gains or losses from disposal of an *extractives asset* reported in a *disclosed segment* that is predominantly reporting *non-extractives revenue* ("non-extractives segment", see Section 3(2)(dd)). This step approximates the *extractives profit* that should be removed using a pro rata approach. The amount of profit removed is the portion of the profit reported for the *non-extractives segment* pro-rated in proportion to the *extractives revenue* reported in the *disclosed segment* to the total revenue reported by the *disclosed segment*. A further deduction is made to remove

unallocated income and *unallocated expenses* attributable to the extractives results in the segment, using a formulaic allocation.

- From that further reduced figure, the last set of deductions removes *extractives profits* as well as certain gains or losses from disposal of an *extractives asset* from segments that are not either predominantly extractives or predominantly non-extractives (“mixed segment”, see Section 3(2)(m)). This is done by removing the third party *extractives revenues* and extractives expenses of the *mixed segment* that were reported in the Consolidated Financial Statements. The last step is that *unallocated income* and *unallocated expenses* attributable to the extractives results in the segment are removed, using a formulaic allocation.

1840. Alternatively, the entity approach may be used. While the disclosed segment approach follows a top-down methodology and starts from the Consolidated Financial Statements and makes adjustments to exclude *extractives revenues* and profits (and to add back inter-segment transactions that were eliminated, where relevant), the entity approach starts with the financial statements of individual entities, then excludes *extractives revenues* and profits from each (as well as certain gains or losses from disposal of an *extractives asset*), and sums their results (subject to some additional adjustments).

1841. The entity approach follows a similar classification system to the disclosed segment approach. It identifies *extractives entities* (those which earn 75 per cent or more of their revenues from extractives) and excludes them in full. It identifies *non-extractives entities* as those which earn 75 per cent or more of their revenues not from extractives. For such entities, the *non-extractives profit* (or loss) is the pro rata portion of the entity’s profit as recorded in the *Entity Financial Accounting Profit (or Loss)* less certain gains or losses from disposal of an *extractives asset*, based on the proportion of non-extractives revenues to total revenues (see definition of *non-extractives entity profit (or loss)*). Finally, it identifies *mixed entities*, which have more than 25 per cent, but less than 75 per cent, of their revenues from extractives. For such entities, the *non-extractives profit* (or loss) is the *Entity Financial Accounting Profit (or Loss)*, less the *extractives revenues*, less certain gains or losses from disposal of an *extractives asset*, and less expenses directly or indirectly incurred in the conduct of *extractives activities* or the derivation of *extractives revenues* (see definition of *mixed entity profit or loss*). The *non-extractives financial accounting profit (or loss)* when using the entity approach is reached by adding the *mixed entity profit (or loss)* of all *mixed entities* and the *non-extractives entity profit (or loss)* of all *non-extractives entities*.

1842. After applying the methodology, the results are retested against the profitability test in Article 3. This is to determine whether the *non-extractives pre-tax profit margin* exceeds 10 per cent. This is done in several steps. First, take the *non-extractives financial accounting profit (or loss)* as calculated under the methodology described above (i.e. the disclosed segment approach or entity approach), and make the necessary adjustments that replicate those ordinarily made under the rules for the tax base. This is referred to as the *non-extractives adjusted profit before tax* of the Group for the Period (see Section 3(2)(n)).

1843. Next, calculate the *non-extractives pre-tax profit margin* (see Section 3(2)(bb)). This calculation does not take into account *relevant net losses*, following the approach in Annex B Section 2(3). There are also two approaches to this calculation. Where the disclosed segment approach was used for calculating the *non-extractives financial accounting profit (or loss)*, the *non-extractives pre-tax profit margin* is calculated by dividing the *non-extractives adjusted profit before tax* by the sum of the *non-extractives adjusted revenues* and the *non-extractives inter-segment revenues*. Where the entity approach was used for calculating the *non-extractives financial accounting profit (or loss)*, the *non-extractives pre-tax profit margin* is calculated by dividing the *non-extractives adjusted profit before tax* by the sum of (a) the revenues reported in the financial statements of all *mixed entities* after deducting *extractives revenues* and (b) the revenues reported in the financial statements of all *non-extractives entities* after deducting *extractives revenues*. In both cases, the revenues reported are included only to the extent that they are

not derived from transactions with another *mixed entity* or *non-extractives entity*. In effect, this counts revenue from intra-group transactions in the denominator for the profit margin, but only those transactions that are with the extractives part of the group.

1844. If the result is that the Group has a *non-extractives pre-tax profit margin* of equal to or below 10 per cent, the Group is out of scope for the Period and there is no need to consider Article 3(2) (i.e. the averaging provision). However, a further test is then applied in the case that a Group satisfies the condition in Article 3(1)(a) but does not satisfy the condition in Article 3(1)(b), to determine if any one of the *disclosed segments* meet the *covered segment* rule, after having removed the results associated with extractives. For example, if the Group had one *extractives segment*, one *non-extractives segment*, and one *mixed segment*, and the result after removing the *extractives profits* is that the combined *non-extractives pre-tax profit margin* is 9 per cent, but on its own the *non-extractives pre-tax profit margin* of the *non-extractives segment* is 11 per cent (and that *disclosed segment* reports revenues in excess of EUR 20 billion), then that *non-extractives segment* is in scope under the *covered segment* rules (subject to meeting the requirements of Article 3(2) as modified by Annex C Section 4) but only with respect to the non-extractives portion of the segment. The other segments are out of scope.

1845. If the result of determining the *non-extractives pre-tax profit margin* is that the Group does have a *non-extractives adjusted profit margin* in excess of 10 per cent, then it is a Covered Group (and there is no further application of the *covered segment* rules). In other words, the Convention is applied to the aggregated profits of all of the non-extractives parts of the Group (i.e. the Convention is not separately applied to each segment on its own).

1846. Finally, when the Group is in scope (or a *covered segment* is in scope) after the removal of the extractives, then the rest of the Convention applies, but only with respect to the non-extractives portion of the Group (or *covered segment*). For example, the nexus test and revenue sourcing rules are only applied with respect to non-extractives and revenues; the formula for the allocation of profits is only with respect to non-extractives and profits; the *marketing and distribution profits safe harbour adjustment* only applies with respect to non-extractives revenues; and the calculations and obligations related to elimination of double taxation only apply with respect to *non-extractives profits*.

1847. In order to give effect to the principle that the calculations and obligations with respect to elimination of double taxation only apply with respect to *non-extractives profits*, additional definitions have been inserted. These are in Section 3(1) (*entity depreciation, entity payroll, entity elimination profit (or loss), Entity Financial Accounting Profit (or Loss), table presence depreciation, taxable presence elimination profit (or loss) and taxable presence payroll*), and in Section 3(2) (*mixed entity depreciation, mixed entity elimination profit (or loss), mixed entity payroll, mixed entity taxable presence depreciation, mixed entity taxable presence elimination profit (or loss), mixed entity taxable presence payroll, non-extractives entity depreciation, non-extractives entity elimination profit (or loss), non-extractives entity taxable presence depreciation, non-extractives entity taxable presence elimination profit or loss, and non-extractives entity payroll*). These definitions allow for the general provisions in the Convention relating to determination of *entity elimination profit (or loss), entity depreciation* and *entity payroll* to be determined for purposes of *non-extractives entities* and *mixed entities* in a way that excludes the relevant portion of profit (or loss), depreciation and payroll of these entities that relate to *extractives activities* and are therefore outside the scope of the Convention.

1848. The definitions included in Annex C Section 3 apply not just for Article 3, but for purposes of the whole Convention. The effect of paragraph 3 is therefore to ensure that the Convention excludes the results of *extractives activities* that are part of a Covered Group.

1849. Article 3(4) also makes provision for an exclusion in respect of a group that includes a *regulated financial institution* and Article 3(8) makes an adjustment in respect of a *defence group*. In the case of a Group that includes a *regulated financial institution* and that is also a *qualifying extractives group* and / or a *defence group*, both the provisions in Article 3(4), (5), and (8) apply. Such a group may apply the exclusions in either order, with the cumulative result that only the non-RFS and non-extractives and non-defence part of the Group can be subject to the remaining provisions of the Convention. However, if the Group is not in scope of the Convention after the application of only one or two of those exclusions, it would not need to apply the other exclusion(s).

Paragraph 2

General definitions

1850. Paragraph 2 provides for definitions that apply to *qualifying extractives groups* for purposes of the Convention. Several of the definitions in paragraph 2 draw on the term *extractives revenues*. That term is defined in paragraph 3 and equally applies for purposes of paragraph 2.

1851. Subparagraphs (a) and (b) provide that the terms “allocation factor” and “disclosed segment”, respectively, have the meaning assigned to it in Section 4. These definitions are relevant for purposes of applying the “disclosed segment approach” to determine the *non-extractives financial accounting profit (or loss)* of the Group. The definition of “allocation factor” provides for a formulaic approach to performing the allocation of income and expenses that are not allocated to any particular reported segment, and *corporate segment income or expenses*, in the context of using the existing *disclosed segments* to calculate the *non-extractives financial accounting profit (or loss)* figure. The definition of *disclosed segment* relies on the segments already reported by the Group in its Consolidated Financial Statements.

1852. Subparagraph (c) defines the term “extractives entity” as any Group Entity for which 75 per cent or more of revenues reported in its financial statements are *extractives revenues*. This effectively applies a “predominance test” with reference to the Entity’s revenues. For this purpose, all revenues reported in the Entity’s financial statements are taken into account, i.e. both third-party and intra-group revenues.

1853. This definition is relevant in the context of applying the entity approach to determine the *non-extractives adjusted revenues* and *non-extractives financial accounting profit (or loss)* of the Group.

1854. Subparagraph (d) defines the term “extractives segment”. This refers to any *disclosed segment* for which 75 per cent or more of the revenues reported by that *disclosed segment* for a Period are *extractives revenues*. For this purpose, all revenues reported in the segment are taken into account, i.e. both third-party and intra-group revenues. This definition effectively applies a “predominance test” with reference to the revenues reported by the *disclosed segment*. This definition is relevant for purposes of applying the disclosed segment approach to determine the *non-extractives financial accounting profit (or loss)* of the Group.

1855. Subparagraph (e) defines the term “mixed entity”. This is a Group entity that is neither an *extractives entity*, nor a *non-extractives entity*. This is a Group entity for which more than 25 per cent, but less than 75 per cent, of its revenues reported in its financial statements are *extractives revenues*. This definition is relevant when using the entity approach to determine the *non-extractives adjusted revenues* and *non-extractives financial accounting profit (or loss)* of the Group.

1856. Subparagraph (f) defines the term “mixed entity depreciation”. Where the Group is using the disclosed segment approach to calculating the *non-extractives financial accounting profit or loss*, then in respect of a *mixed entity* which has all of its revenues reported in an *extractives segment*, the *mixed entity’s*

depreciation is deemed to be zero. In respect of all other *mixed entities*, the *mixed entity depreciation* is defined as *entity depreciation* after excluding amounts incurred in the conduct of *extractives activities* or the derivation of *extractives revenues*. This requires that all *entity depreciation* of a Group Entity, as determined in accordance with Annex B Section 5 must be attributed either directly or indirectly to either the out-of-scope component of such Group Entity (i.e., the conducting of *extractives activities* or derivation of *extractives revenues*) or the remaining in-scope component of such Group Entity. Such attribution would need to be performed on a reasonable basis having regard to the business activities that derive benefit from the costs in question. This has the effect that the calculation of the *entity's depreciation* for the purpose of calculating the elimination obligations will only be with respect to the non-extractives depreciation.

1857. Subparagraph (g) defines the term “mixed entity elimination profit (or loss)”. This starts with the *mixed entity financial accounting profit (or loss)*, but that amount is further adjusted in one of two ways. First, where the Group is using the disclosed segment approach to calculating the *non-extractives financial accounting profit or loss*, then in respect of a *mixed entity* which has all of its revenues reported in an *extractives segment*, the *mixed entity's* elimination profit (or loss) is deemed to be zero. In all respect of all other *mixed entities*, the extractives items must be removed from the *mixed entity financial accounting profit (or loss)*, before applying the ordinary adjustments required by the Elimination Profit (or Loss). Those extractives items are *extractives revenues*, gains and losses relating to the disposal of an *extractives asset* (that is, whether treated as revenue or not, but only if they are reported in the financial statements of *the mixed entity* that is resident in, or its Taxable Presence located in, the Jurisdiction where the *extraction* is undertaken, in line with the principle of the *extractives revenues* that are otherwise excluded), and expenses directly or indirectly incurred in the conduct of *extractives activities* or in deriving *extractives revenue*. This has the effect that the calculation of the Entity's profit (or loss) for the purpose of calculating the elimination obligations will only be with respect to the *non-extractives profit or (loss)*.

1858. Subparagraph (h) defines the term “mixed entity financial accounting profit (or loss)”. This definition is relevant in the context of applying the entity approach to determine the *non-extractives adjusted revenues* and *non-extractives financial accounting profit (or loss)* of the Group. Where the Group is using the disclosed segment approach to calculating the *non-extractives financial accounting profit or loss*, then in respect of a *mixed entity* which has all of its revenues reported in an *extractives segment*, the *mixed entity's depreciation* is deemed to be zero. In respect of all other *mixed entities*, it requires identifying the *extractives revenues* and related expenses, as well as the gains or losses from the disposal of an *extractives asset* but only if they are reported in the financial statements of the *mixed entity* that is resident in, or its Taxable Presence located in, the Jurisdiction where the *extraction* is undertaken, in line with the principle of the *extractives revenues* that are otherwise excluded, and deducting those from the Entity Financial Accounting Profit (or Loss) to arrive at the remaining *mixed entity* profit (or loss).

1859. Subparagraph (i) defines the term “mixed entity payroll”. Where the Group is using the disclosed segment approach to calculating the *non-extractives financial accounting profit or loss*, then in respect of a *mixed entity* which has all of its revenues reported in an *extractives segment*, the *mixed entity's depreciation* is deemed to be zero. In respect of all other *mixed entities*, *mixed entity payroll* is defined as *entity payroll* after excluding amounts incurred in the conduct of *extractives activities* or the derivation of *extractives revenues*. Consistent with *mixed entity depreciation*, described in paragraph 1856, this requires that all *entity payroll* of a Group Entity, as determined in accordance with Annex B Section 5 must be attributed either directly or indirectly to either the out-of-scope component of such Group Entity or the remaining in-scope component of such Group Entity on a reasonable basis. This has the effect that the calculation of the entity's payroll for the purpose of calculating the elimination obligations will only be with respect to the non-extractives payroll.

1860. Subparagraph (j) defines the term “mixed entity taxable presence depreciation”. It means the *taxable presence depreciation* of the *taxable presence* of the *mixed entity* (as otherwise determined for

elimination purposes), then further adjusted to exclude amounts incurred in the conduct of *extractives activities* or the derivation of *extractives revenues*. This is the same approach as for determining *mixed entity depreciation*, albeit only with regard to the Taxable Presence of that entity.

1861. Subparagraph (k) defines the term “mixed entity taxable presence elimination profit (or loss)”. This broadly mirrors the calculations required for a *mixed entity elimination profit (or loss)* but adjusted to account for the fact that it is only in respect of the Taxable Presence. Where the Group is using the disclosed segment approach to calculating the *non-extractives financial accounting profit or loss*, then in respect of a *mixed entity* that is subject to the Taxable Presence and which has all of its revenues reported in an *extractives segment*, the *mixed entity’s* elimination profit (or loss) is deemed to be zero.

1862. In respect of all other Taxable Presences of *mixed entities*, it starts with the *taxable presence elimination profit (or loss)* determined under Annex B Section 4. Where there are not separate financial statements for the Taxable Presence that are followed for tax purposes, then the *taxable presence elimination profit or loss* is as determined by Annex B Section 4, whereby the full *taxable presence elimination profit (or loss)* is multiplied by the *main entity’s* non-extractives revenues then divided by the *main entity’s* total revenues. The definition of *mixed entity taxable presence elimination profit (or loss)* then excludes extractives items. Those extractives items are *extractives revenues*, gains and losses relating to the disposal of an *extractives asset* (that is, whether treated as revenue or not but only if they are reported in the financial statements of the Taxable Presence located in the Jurisdiction where the *extraction* is undertaken, in line with the principle of the *extractives revenues* that are otherwise excluded), and expenses directly or indirectly incurred in the conduct of *extractives activities* or in deriving *extractives revenue*. This has the effect that the calculation of the Taxable Presence’s profit (or loss) for the purpose of calculating the elimination obligations will only be with respect to the non-extractives profit or (loss).

1863. Subparagraph (l) defines the term “mixed entity taxable presence payroll”. It means the *taxable presence payroll* of the *Taxable Presence* of the *mixed entity* (as otherwise determined for elimination purposes), then further adjusted to exclude amounts incurred in the conduct of *extractives activities* or the derivation of *extractives revenues*. This is the same approach as for determining *mixed entity payroll*, albeit only with regard to the Taxable Presence of that entity.

1864. Subparagraph (m) defines the term “mixed segment”. This refers to any *disclosed segment* that is not an *extractives segment* or a *non-extractives segment*. This effectively captures *disclosed segments* whose (third-party and intra-group) revenues are comprised more than 25 per cent, but less than 75 per cent, of *extractives revenue*. This definition is relevant for purposes of applying the disclosed segment approach to determine the *non-extractives financial accounting profit (or loss)* of the Group.

1865. Subparagraph (n) defines the term “non-extractives adjusted profit before tax”. The definition follows closely the mechanism in Annex B Section 2 to make adjustments to the tax base, and to deduct non-extractives relevant losses, except that it is based on the Covered Group’s *non-extractives financial accounting profit (or loss)*.

1866. Subparagraph (o) defines “non-extractives adjusted revenues”. This term is relevant to the revenue test in Article 3(1)(a), and as the basis for determining and allocating the amount of *taxable profit* of a Covered Group that conducts *extractives activities*. *Non-extractives adjusted revenues* of a Group for a Period means the Adjusted Revenues of the Group for the Period modified to exclude all revenues that are *extractives revenues*. In relying on the defined term ‘extractives revenues’, the definition refers only to the specific types of revenues that fall within that definition, including revenues booked in the Jurisdiction of *extraction*. By starting with the defined term ‘Adjusted Revenues’ of the Group (i.e. the term as generally used throughout the Convention, rather than that term as replaced in Section 3 of the Annex) it means that the term *non-extractives adjusted revenues* only excludes *extractives revenues* that were otherwise

included in the Consolidated Financial Statements (i.e. third party revenues). As such, the revenue test in Article 3(1)(a) ensure that the non-extractives revenue test will only be met where the non-extractives third-party revenue exceeds EUR 20 billion.

1867. Subparagraph (p) defines the term “non-extractives eligible net losses”. This definition follows that found in Annex B Section 2(5)(a), but ensures that only losses from non-extractives activities are included in the calculation. The same approach is taken with respect to *regulated financial institutions*.

1868. Subparagraph (q) defines the term “non-extractives eligible prior period”. This definition follows that found in Annex B Section 2(5)(b), but applies by reference to *non-extractives unused losses*. This ensures that only those losses related to non-extractives activities are captured.

1869. Subparagraph (r) defines the term “non-extractives entity”. It is a Group entity for which 75 per cent or more of its revenues, as reported in its financial statements, are not *extractives revenues*. This definition is relevant when using the entity approach to determine the *non-extractives adjusted revenues* and *non-extractives financial accounting profit (or loss)* of the Group.

1870. Subparagraph (s) defines the term “non-extractives entity depreciation”. Where the Group is using the disclosed segment approach to calculating the *non-extractives financial accounting profit or loss*, then in respect of a *non-extractives entity* which has all of its revenues reported in an *extractives segment*, the non-extractive entity’s depreciation is deemed to be zero. In respect of all other *non-extractives entities*, the *non-extractives entity depreciation* is defined as *entity depreciation* that would otherwise be determined under Annex B Section 4 (Elimination Profit (or Loss)) multiplied by the *non-extractives entity financial accounting profit (or loss)* then divided by Entity Financial Accounting Profit (or Loss). This requires that all *entity depreciation* of a Group Entity, as determined in accordance with Annex B Section 5 must be allocated based on the ratio of *non-extractives profits* to total profits of the Group Entity. This quantitative approach is taken on the basis that such Group Entities are comprised predominantly of non-extractives activities and therefore a more streamlined approach is taken to allocate expenses without significant inaccuracy arising.

1871. Subparagraph (t) defines the term “non-extractives entity elimination profit (or loss)”. This means the *non-extractives entity financial accounting profit (or loss)*, further adjusted in one of two ways. Where the Group is using the disclosed segment approach to calculating the *non-extractives financial accounting profit or loss*, then in respect of a *non-extractives entity* which has all of its revenues reported in an *extractives segment*, the non-extractive entity’s elimination profit (or loss) is deemed to be zero. In respect of all other *non-extractives entities*, the adjustments required for the Elimination Profit (or Loss) are performed on a pro rata basis, in the same proportion as was used in calculating the *non-extractives entity financial accounting profit (or loss)* i.e. the proportion of non-extractives revenue to total revenues for that entity. This has the effect that the calculation of the entity’s profit (or loss) for the purpose of calculating the elimination obligations will only be with respect to the *non-extractives profit or (loss)*.

1872. Subparagraph (u) defines the term “non-extractives entity financial accounting profit (or loss)”. This definition is relevant in the context of applying the entity approach to determine the *non-extractives adjusted revenues* and *non-extractives financial accounting profit (or loss)* of the Group. It follows a similar concept as the approach taken to a *non-extractives segment* when using the disclosed segment approach. In doing so, it adjusts the Entity Financial Accounting Profit (or Loss) of the *non-extractives entity* to exclude gain or loss from the disposal of an *extractives asset* but only if they are reported in the financial statements of the *non-extractives entity* that is resident in, or its Taxable Presence located in, the Jurisdiction where the *extraction* is undertaken, in line with the principle of the *extractives revenues* that are otherwise excluded, and then reducing that proportionally by reference to the proportion that the non-extractives

revenues reported in the entity's financial statements (i.e. both third party and intra-group revenues) are to the total revenues of the entity.

1873. Subparagraph (v) defines the term “non-extractives entity payroll”. Where the Group is using the disclosed segment approach to calculating the *non-extractives financial accounting profit or loss*, then in respect of a *non-extractives entity* which has all of its revenues reported in an *extractives segment*, the non-extractive entity's payroll is deemed to be zero. In respect of all other *non-extractives entities*, the *non-extractives entity payroll* is defined as *entity payroll* multiplied by the *non-extractives entity profit (or loss)* then divided by Entity Profit (or Loss). Consistent with *non-extractives entity depreciation*, this requires that all *entity payroll* of a Group Entity, as determined in accordance with Annex B Section 5 must be attributed either directly or indirectly to either the out-of-scope component of such Group Entity or the remaining in-scope component of such Group Entity based on a profit *allocation key*.

1874. Subparagraph (w) defines the term “non-extractives entity taxable presence depreciation”. It means the *taxable presence depreciation* of the Taxable Presence of the *non-extractives entity* multiplied by a proportion. That proportion is the *non-extractives entity financial accounting profit (or loss)* then divided by Entity Financial Accounting Profit (or Loss). This is the same approach as for determining *non-extractives entity depreciation*, albeit only with regard to the Taxable Presence of that entity.

1875. Subparagraph (x) defines the term “non-extractives entity taxable presence elimination profit (or loss)”. Where the Group is using the disclosed segment approach to calculating the *non-extractives financial accounting profit or loss*, then in respect of a *non-extractives entity* that is subject to the Taxable Presence and which has all of its revenues reported in an *extractives segment*, the *mixed entity's Elimination Profit (or Loss)* is deemed to be zero.

1876. In all respect of all other *non-extractives entity taxable presences*, it starts with the *taxable presence elimination profit (or loss)* determined under Annex B Section 4. Where there are not separate financial statements for the Taxable Presence that are followed for tax purposes, then the *taxable presence elimination profit or loss* is as determined by Annex B Section 4, whereby the full *taxable presence elimination profit (or loss)* is multiplied by the *main entity's* non-extractives revenues then divided by the *main entity's* total revenues. This is then reduced by a proportion so that only non-extractives items are captured. That proportion is the same proportion as was used in calculating the *non-extractives entity financial accounting profit (or loss)* i.e. the proportion of non-extractives revenue to total revenues for that entity. Those extractives items are *extractives revenues*, gains and losses relating to the disposal of an *extractives asset* (that is, whether treated as revenue or not but only if they are reported in the financial statements of an Entity that is resident in, or a Taxable Presence located in, the Jurisdiction where the *extraction* is undertaken, in line with the principle of the *extractives revenues* that are otherwise excluded), and expenses directly or indirectly incurred in the conduct of *extractives activities* or in deriving *extractives revenue*. This has the effect that the calculation of the Taxable Presence's profit (or loss) for the purpose of calculating the elimination obligations will only be with respect to the *non-extractives profit (or loss)*.

1877. Subparagraph (y) defines the term “non-extractives entity taxable presence payroll”. It means the *taxable presence payroll* of the Taxable Presence of the *non-extractives entity* multiplied by a proportion. That proportion is the *non-extractives entity financial accounting profit (or loss)* then divided by Entity Financial Accounting Profit (or Loss). This is the same approach as for determining *non-extractives entity payroll*, albeit only with regard to the Taxable Presence of that entity.

1878. Subparagraph (z) provides two alternative approaches to calculate the *Group's non-extractives financial accounting profit (or loss)*: the disclosed segment approach (subparagraph (z)(i)) and the entity approach (subparagraph (z)(ii)). The aim in both cases is to isolate the profits (or losses) of the non-extractives part of the Group as though it formed its own separate Group. As such, the Group's *non-*

extractives financial accounting profit (or loss) comprises third-party revenues and expenses, as well as certain intra-group revenues and expenses. In both approaches, the rule draws upon the defined term *extractives revenues*. As this term does not refer only to revenues that are reported in the Consolidated Financial Statements (i.e. after elimination of intra-group transactions), but all revenues that meet this definition, the effect in applying the rest of the mechanical rules is that profits from extractives are still excluded if they were earned from other members in the Group. This further has the effect that only the *extractives profits* (i.e. those related to the *extractives revenues* as defined, including therefore the profits booked in the Jurisdiction of *extraction*) are excluded.

1879. Subparagraph (z)(i) sets out the disclosed segment approach to determine the Covered Group's *non-extractives financial accounting profit (or loss)*. This approach applies at the election of the Group, if the Group reports one or more *disclosed segments*. Under the disclosed segment approach, the *non-extractives financial accounting profit (or loss)* of the Group is calculated by taking the Financial Accounting Profit (or Loss) of the Group, as defined in Article 2 and sequentially performing the deductions under clauses (A), (B) and (C). Clause (A) relates to a segment that reports predominantly *extractives revenue* ("an extractives segment"), where predominant is measured as 75 per cent of the *disclosed segment* revenues. Clause (B) relates to a segment that reports predominantly non-extractives revenue ("a non-extractives segment"), where predominant is measured as 75 per cent of the *disclosed segment* revenues. Clause (C) relates to a segment that does not meet either predominance test ("a mixed segment").

1880. First, under clause (A), the following adjustments must be made to the Financial Accounting Profit (or Loss) of the Group where any *disclosed segment* is an *extractives segment* (defined in paragraph 2(e)): (1) to exclude all revenues and expenses reported in any *extractives segment* reported in the Consolidated Financial Statements; (2) to include all revenues and expenses reported in any non-extractives segment or any *mixed segment* from transactions with an *extractives segment*; (3) to exclude any *unallocated income, unallocated expense, and corporate segment income or expense* that are allocable to any *extractives segment* using the *allocation factor* applicable to the *disclosed segment* (see discussion in Annex C Section 4 for further detail); and (4) to exclude gains or losses from disposal of an *extractives asset* but only if they are reported in the financial statements of an Entity that is resident in, or a Taxable Presence located in, the Jurisdiction where the *extraction* is undertaken, in line with the principle of the *extractives revenues* that are otherwise excluded.

1881. Under clause (B), a second series of adjustments are made to the Financial Accounting Profit (or Loss) of the Group – as adjusted by clause (A) – where any *disclosed segment* is a non-extractives segment (defined in paragraph 2(w)). The purpose is start with the results of clause (A), and to further deduct the portion of the segment that represents the *extractives profits* reported in the segment.

1882. There are two parts to clause (B). The purpose of the first part of clause (B) is to use the *segment financial accounting profit (or loss)* (as calculated under Annex C Section 4) as the starting point, exclude gains or losses from disposal of an *extractives asset* but only if they are reported in the financial statements of an Entity that is resident in, or a Taxable Presence located in, the Jurisdiction where the *extraction* is undertaken, in line with the principle of the *extractives revenues* that are otherwise excluded, and to adjust that proportionally by reference to the proportion that the *extractives revenues* reported in the segment (i.e. both third party and intra-group revenues) are to the total revenues of the segment. This is a way to use the reported profit figure (as adjusted), and exclude a portion of that profit that is attributable to extractives, using a pro rata calculation. It makes that calculation by multiplying the revenues reported in the *non-extractives segment* that are *extractives revenues* by a quotient. That quotient is that segment's financial accounting profit (or loss) as calculated under Annex C Section 4, and divided by the total revenues reported by that segment for the Period. For example, if the *extractives revenues* reported in the segment were EUR 20, the *segment financial accounting profit (or loss)* was EUR 10, and the total

revenues reported by the segment were EUR 100, then the first part of clause (B) would find that the amount of *extractives profit* to be deducted was $[20 \times (10/100)] = 2$.

1883. The second part of clause (B) requires additional adjustments to exclude *unallocated income* and *corporate segment income*, less any *unallocated expenses* and *corporate segment expense*, that are allocable to the *non-extractives segment* (using the *allocation factor*). It excludes the amount that the *extractives revenues* of the segment bear to the total revenues of the *non-extractives segment*.

1884. Third, under clause (C), a third and final series of adjustments is made, starting with the results calculated under clauses (A) and (B), where a *disclosed segment* is a *mixed segment*. There are four cumulative adjustments. First, to exclude *extractives revenues* reported in the *mixed segment* in the Consolidated Financial Statements (i.e. the third party revenues attributable to extractives). Second, to exclude gains or losses from disposal of an *extractives asset* but only if they are reported in the financial statements of an Entity that is resident in, or a Taxable Presence located in, the Jurisdiction where the *extraction* is undertaken, in line with the principle of the *extractives revenues* that are otherwise excluded. Third, to exclude expenses reported in the *mixed segment* reported in the Consolidated Financial Statements that are directly or indirectly incurred in the conduct of *extractives activities* or the derivation of *extractives revenues*. Direct and indirect expenses refers to the expenses that are already allocated to the *mixed segment* as reported in the Consolidated Financial Statements and no further appointment or cost allocation is required. Fourth, to exclude *unallocated income* and *corporate segment income*, less any *unallocated expenses* and *corporate segment expense*, that are allocable to the *mixed segment* (using the *allocation factor*). The amount that is deducted is the amount determined by applying the ratio of the *extractives revenues* of the segment divided by the total revenues of the *mixed segment*.

1885. Subparagraph (z)(ii) sets out the entity approach to determine the Group's *non-extractives financial accounting profit (or loss)*. This approach applies at the election of the Group, or where it does not report *disclosed segments* and therefore cannot apply the disclosed segment approach described in subparagraph (z)(i). Under the entity approach, the Group's *non-extractives financial accounting profit (or loss)* is calculated by adding the *mixed entity financial accounting profit (or loss)* of all *mixed entities* and the *non-extractives entity financial accounting profit (or loss)* of all *non-extractives entities*. It does not add the results of any *extractives entities*, which are excluded in full. See definitions of *mixed entity profit (or loss)* and *non-extractives entity profit (or loss)*.

1886. Subparagraph (aa) defines the term “non-extractives inter-segment revenues” to mean the sum of revenues reported in a *mixed segment* and *non-extractives segment* that relate to transactions with an *extractives segment*, but not including revenues that are *extractives revenues*. This definition applies for purposes of determining the Group's *non-extractives pre-tax profit margin* when using the disclosed segment approach. It is the mechanism by which relevant intra-group revenues are added back (given that they were eliminated in the consolidated financial statements), that gives effect to the principle that the extractives portion of the Group is treated as a separate Group for the purpose of calculating the exclusion.

1887. Subparagraph (bb) defines the term “non-extractives pre-tax profit margin”. There are two approaches to calculating the *non-extractives pre-tax profit margin*, the disclosed segment approach and the entity approach.

1888. If the disclosed segment approach is used for calculating the *non-extractives financial accounting profit (or loss)*, the *non-extractives pre-tax profit margin* is calculated by taking the *non-extractives adjusted profit before tax* of the Group for the Period, without taking into account *non-extractives relevant net losses*, and dividing that amount by the sum of the *non-extractives adjusted revenues* and the *non-extractives inter-segment revenues* of the Group for the Period. This mirrors the approach taken to the calculation of the *pre-tax profit margin* of a Group, defined in Article 3(3), but is adjusted to remove the profit and

revenues derived from extractives, and ensures that transactions within the extractives part of the group and the rest of the group are taken into account.

1889. If the entity approach is used for calculating the *non-extractives financial accounting profit (or loss)*, the *non-extractives pre-tax profit margin* is calculated by taking the *non-extractives adjusted profit before tax* of the Group for the Period, without taking into account *non-extractives relevant net losses*, and dividing that amount by the sum of the *non-extractives adjusted revenues*, and relevant intra-group revenues. Those are the revenues reported in the financial statements of all *mixed entities* after deducting *extractives revenues* and the revenues reported in the financial statements of all *non-extractives entities* after deducting *extractives revenues*, to the extent that those revenues are not derived from transactions with another *mixed entity* or *non-extractives entity*. This means that the rule removes the profit and revenues derived from extractives, and ensures that transactions within the extractives part of the group and the rest of the group are taken into account. In effect, that requires reconsolidation of the results of the *non-extractives entities* and *mixed entities*, after excluding the extractives results.

1890. Subparagraph (cc) contains the definition of “non-extractives relevant net losses”. These are the losses to be carried forward and deducted in the calculation of the Covered Group’s *non-extractives adjusted profit before tax* for a Period. The definition ensures that the calculation of *relevant net losses* for Groups that conduct *extractives activities* only includes the appropriate losses (i.e. not the losses that relate to the extractives). *Non-extractives relevant net losses* include the same two components as *relevant net losses* in the general rules under Annex B Section 2(3), except they are calculated with reference only to the appropriate losses. First, *non-extractives relevant net losses* always include the *non-extractives eligible net losses* (i.e. historical losses incurred within the Covered Group itself). Second, they can also include *transferred losses* (i.e. historic losses incurred by a separate business that has since been transferred to the Covered Group). Such *transferred losses* are determined in accordance with the general rules in Annex B Section 2(3)(b) and (4) (including as they relate to the modalities of lodging the election), but with reference only to the appropriate (i.e. non-extractives) losses of the transferred group, entity or *predecessor group*. This second part of the definition is only relevant if the Covered Group has made an election to recognise *transferred losses* in respect of a particular business combination or division. See the discussion in Annex B Section 2(3)(b) for further detail. Note that losses that relate to the extractives are not carried forward (for example, where a Group carried out *exploration* in a Period, which was an expense that created a loss, and the generation of resulting *extractives revenue* and profits do not arise until some years later). In the event that the extractives business becomes profitable in the future, there is no need for using such previous losses, given that the profit relating to the extractives business is excluded in any event. The same approach is taken with respect to *regulated financial institutions*.

1891. Subparagraph (dd) defines the term “non-extractives segment”. This refers to any *disclosed segment* for which 75 per cent or more of the revenues reported in the *disclosed segment* for a Period are not *extractives revenues*. This definition is relevant for purposes of applying the disclosed segment approach to determine the *non-extractives financial accounting profit (or loss)* of the Group.

1892. Subparagraph (ee) defines the term “non-extractives unused loss”. This definition follows that found in Annex B Section 2(5)(h), but provides that the loss is calculated by reference to the non-extractives financial accounting profit and loss of a prior Period and therefore removes the profits and losses derived from *extractives activities*.

1893. Subparagraph (ff) defines the term “revenues”. This includes *revenues* derived from an *extractives joint venture* in the same proportion as the Group’s share of profit or loss derived from the *extractives joint venture*. This is to clarify that for the purpose of the calculations in paragraph 2, the results of an *extractives joint venture* must be taken into account, even if such results were not reported in the “revenue” line item in the relevant financial statements. Once included in the term *revenues*, the rest of the mechanical

calculations in paragraph 2 then ensure that both the relevant revenue and profits from an *extractives joint venture* are excluded from the Convention. *Extractives joint venture* is defined in paragraph 3. Not all *revenue* from an *extractives joint venture* qualifies for the exclusion. This is explained in the discussion of the definition of *extractives revenue* below.

1894. Subparagraphs (gg) and (hh) define the term “unallocated expense” and “unallocated income”. These have the meaning assigned to it in Annex C Section 4, and the explanation in the Explanatory Statement equally applies in this context.

Paragraph 3

Definition of qualifying extractives group and related terms

1895. Paragraph 3 provides additional definitions for applying the Convention to a *qualifying extractives group*. These definitions apply to identify a *qualifying extractives group*, all other definitions necessary to support that definition, and to perform the calculations required in paragraph 2.

Qualifying extractives group

1896. The definition of a *qualifying extractives group* in subparagraph (a) contains a gateway test. This gateway test is applied by looking at the Group as a whole, and not separately for each transaction, project or segment.

1897. A Group that meets the gateway test is a *qualifying extractives group*. This can be the case even if the Group engages in a significant number of activities that are not *extractives activities* or is engaged in a relatively small amount of *extractives activities*. This is so because any amount of *extractives profits* that meets the relevant definitions is always excluded by these provisions in the Convention. In other words, the purpose of the gateway test is to act as an integrity measure to ensure the Group does engage in some *extractives activities*, rather than a test that requires the Group to be primarily or predominantly engaged in *extractives activities*.

1898. The amount of the profits of the Group that would be excluded by virtue of being profits derived from extractives is then determined separately by the rest of the provisions in Annex C Section 3. Those mechanical calculation provisions use a ‘predominance’ test when using the disclosed segment approach, not because a Group must derive predominantly *extractives revenue*, but as a simplified methodology for isolating the *extractives revenue* and *extractives profits* once it has already been determined that the Group is a *qualifying extractives group*.

1899. The definition of a *qualifying extractives group* contains a dual test, both limbs of which must be satisfied. The first is an activity test, and the second is a revenue test. Each limb is discussed in turn.

1900. The activities limb of the test provides that in order to be a *qualifying extractives group*, the Group must be engaged in *exploration, development* or *extraction* as a principal on its own account. The language uses the term *exploration, development* “or” *extraction*, to signify that a Group is not required to do all three activities in order to meet the activities limb of the test. In practice, many Groups will also be engaged in *extraction*. However, this language provides for cases where a Group that is in scope of the Convention is only engaged in the *exploration* or *development*.

1901. The terms *exploration, development* or *extraction* are used in this definition, instead of the wider defined term *extractives activities*, which covers a wider range of activities, such as certain processing and transportation. This is to focus the test on whether the Group is engaged in the activities directly connected with the initial *exploration, development* or *extraction* which are unique to the extractives business. A

consequence of this is that a Group would not be a *qualifying extractives group* if: it is only engaged in purchasing another Group's *extractive products* to perform processing without doing the *extraction* (such as a refinery or smelter), only engaged in transportation (such as a pipeline), or only engaged in trading and selling extractives commodities.

1902. The language refers to being engaged in the activities as a principal on its own account, or under a *resource development agreement*. The first part of this language "principal on its own account" is to signify that the Group must be involved in and exposed to the economic risks of the *exploration, development* or *extraction*. For example, the holder of the licence or rights to explore or exploit would generally be acting as a principal on its own account. It does not require that the Group be conducting the *exploration, development* or *extraction* itself (and for this reason, the language further uses the term "engaged in" rather than "conducting"). This accounts for cases where a Group engages a contractor or service provider to conduct the *exploration, development* or *extraction* on behalf of the Group. In these cases, the Group still bears the economic risks that are associated with the activities, and maintains the interest in the underlying licences and the *extractive product* that is ultimately extracted. For example, a Group engaged in *exploration* that acts as a principal on its own account bears the economic risks of the *exploration* proving to be unsuccessful or not commercially viable to extract. A Group engaged in *development* that acts as a principal on its own account bears the economic and *financial risks* associated with the *development* - cost overruns for example. A Group engaged in *extraction* that acts as a principal on its own account bears the economic risks of the product being more costly to extract i.e. higher operating costs than the feasibility study and economic modelling suggested, for example.

1903. A contractor or service provider, on the other hand, is not engaged in *exploration, development* or *extraction* within the meaning of paragraph 3(a). A contractor or service provider earns service revenue for the performance of its functions and bears risk in relation to the performance of the services provided which may not be linked to the successful outcome of the *exploration, development, or extraction*. Consequently, the contractor or service provider is insulated from the underlying risks and successes of the *exploration, development* or *extraction* activities to derive an *extractive product* i.e. market risk, price risk, resource availability risk, volume risk etc. As such, the contractor or service provider is not engaged in the activities as a principal on its own account, and the revenue and profits that are derived by the contractor or service provider is not subject to the exclusion.

1904. The test for whether a group is acting as a principal on its own account focuses on the differing risk profiles between the contractor or service provider and a Group engaged in extractives as generally the functions would be similar if the contractor or service provider or a Group conducted the activities themselves. As a result, the test focuses on the entity that bears the economic risks as they are entitled to the economic rents that are derived directly from the *extractives activities* and revenue and profits will be ultimately taxed by the source Jurisdiction.

1905. The reference to acting as a principal on its own account is also within the context of the chapeau language, which recognises that a Group can be a *qualifying extractives group* where the relevant activities are conducted directly, or indirectly through an *extractives joint venture* or *resource development agreement*. For example, under a *resource development agreement*, the government may retain title to the underlying resource but has engaged the Group to act as contractor or concessionaire. This is different from the case of a contractor or service provider referred to above, because under a *resource development agreement*, the Group still bears economic risks associated with the project (such as having access to the extracted product and/or being entitled to a share of the profits), rather than earning a service fee for the provision of service functions only. See further discussion under the definitions of *extractives joint venture* and *resource development agreement*.

1906. The revenue limb of the gateway test is that the Group must derive *extractives revenues*, which in aggregate have a substantial connection with its *exploration, development* or *extraction*. *Extractives revenues* is a defined term, which means revenues from *extractives activities* (including certain processing and transportation), sales of extractives products and products resulting from *qualifying processing*, associated gains and losses from derivative instruments, and sales of *extractives assets* held in the course of carrying out the Group's *extractives activity*. As such, the definition of *extractives revenue* is broader than just revenues derived from *exploration, development* or *extraction*, meaning that the scope of the exclusion of profits from Extractives is wider than *exploration, development* or *extraction*. The meaning of extractives revenues is further discussed below under that definition, and that discussion applies also for purposes of the revenue limb of the gateway test. For example, with respect to a Group that was only engaged in *exploration* or only engaged in *development*, in such cases, the exclusion will only apply with respect to revenue (and profits) that meet the definition of *extractives revenues*. This includes that such revenues are booked in the Jurisdiction where the *extraction* would take place (see discussion in paragraphs 1938 through 1939 for how this applies in the context of *exploration* and *development*, which occurs prior to and possibly without any subsequent *extraction*). This means that the exclusion would not apply for a Group engaged only in *exploration* or *development* which was booked remotely from the Jurisdiction of *extraction* because such revenues would not meet the definition of *extractives revenues*; rather, it will necessarily be revenue and profits that are taxable by the Jurisdiction of *extraction*.

1907. In other words, to apply the exclusion, a Group would follow these two tests, in order. First: is the Group engaged in *exploration, development* or *extraction* as a principal on its own account, as per the first limb of the definition? If no, then the group does not qualify for the exclusion (even if it does the other activities that could have generated *extractives revenues*, such as *qualifying processing*). Second: if the answer to the first question is yes, then does the Group meet the second limb of the gateway test? If yes, then the Group's revenues from the wider range of *extractives activities* can be excluded (i.e. the *exploration* revenues, *development* revenues, *extraction* revenues, *qualifying processing* revenues, and *qualifying transportation* revenues), as well as other items within the definition of *extractives revenues*.

1908. However, because the scope of *extractives revenues* that can qualify for the exclusion is broader than this initial test looking at whether the Group is engaged in *exploration, development* or *extraction*, there is need for an integrity measure. This is the "substantial connection" test, contained in the second, revenue limb of the gateway test. It ensures that the types of *extractives revenues* that are beyond *exploration, development* or *extraction* (such as revenue from *qualifying processing*, certain revenue from derivatives, or revenue from *qualifying transportation*) are not unduly brought within the exclusion, for example, because that is their main business, and it is not connected to the *exploration, development* or *extraction* activities of the Group. The substantial connection test asks whether there is a sufficient relationship between the *extractives revenue* and the Group's *exploration, development* or *extraction*.

1909. The substantial connection between the *extractives revenue* and the *exploration, development* or *extraction* is tested in the aggregate. This means that the test does not apply per tonne or barrel, for example, to determine whether the connection between the *extractives revenue* and the activity is substantial for every transaction or for each type of *extractive product*. In addition, it would be difficult to set a bright line test for whether in quantitative terms the Group's revenue is proportionate to the *exploration, development* or *extraction*, for example given the risks involved in *exploration* and the long lead time from which no revenues may be derived, given that the test is not governed by the ultimate size of the Group, and given the volatility in the extractives industry where revenues can be governed by external market factors. Rather, the substantial connection test means looking at the Group's extractives business overall, to understand whether the Group's derivation of *extractives revenue* is connected to the Group's engagement in *exploration, development* or *extraction*. This means it is not a granular, quantitative inquiry, but an overall qualitative inquiry, to which the answer is either 'yes' or 'no'.

1910. The focus of the test is the relationship between the *exploration, development or extraction* and the *extractives revenue*. It is not intended to mean that a Group can only be a *qualifying extractives group* if substantially all of its revenues are *extractives revenues*. For example, a conglomerate may be genuinely engaged in *extraction* deriving *extractives revenues* that reflect its engagement in *exploration, development or extraction*, even though they are diversified and generate revenue from non-extractive sources. The Group can still be a *qualifying extractives group*, and its *extractives profits* must still be excluded from the scope of the Convention. For the same reason the “substantial connection” test does not require that the size of the *extractives revenues* be significant in absolute terms for the Group. For example, a conglomerate may have a small interest in proportion to the absolute size of the Group in an extractive project (where it is engaged in the *extraction* through the relevant *extractives joint venture partners*), and the Group could still be a *qualifying extractives group*.

1911. To simplify the substantial connection test, where the Group is engaged in a significant amount of *exploration, development or extraction* in absolute terms, it is presumed to have met the “substantial connection” test e.g. large oil and gas and mining Groups. This could include, but not be limited to, the following:

- a Group holds multiple licenses or rights to explore or extract in the ordinary course of its business;
- a Group is required to comply with accounting standards unique to *extraction*, such as Financial Accounting Standards Board Extractive Activities – Oil and Gas, or Committee for Mineral Reserves International Reporting Standards – for Mining;
- the balance sheet of the Group discloses mining properties, *exploration/ evaluation/ mineral resource assets* or mining/ *mineral right assets* (or *hydrocarbon equivalents* i.e. proved and probable oil reserves);
- disclosure of reserves or extractive resources under domestic or international reporting standards;
- industry codes, such as North American Industry Classification System, indicating the primary activity is related to *extraction* (such as crude petroleum *extraction*, natural gas *extraction*, iron ore mining, all other metal ore mining).

1912. On the other hand, the substantial connection test would not be met where the engagement of the Group in *exploration, development or extraction* is disconnected or unrelated to the *extractives revenues* of the Group. Disconnected or unrelated means that the substantial connection test would not be able to be met, for example, where a Group’s *exploration, development or extraction* is in respect of a different kind of *extractive product* from which the Group is deriving most of its *extractives revenues*. Likewise, it would not be met if close to all of its *extractives revenues* are from a business function that is not reliant on and is separate from the Group’s *exploration, development or extraction*; in other words, where the Group’s production of *extractive products* does not affect the size, risk or success of the rest of the Group’s *extractives revenues*. Examples of this include where the Group:

- has immaterial investments in oil *extraction*, but earns close to all of its profits from commodities trading, including substantial trading in commodities that are not oil and are unconnected to the Group’s own interests in oil *extraction*.
- engages in an immaterial amount of oil *extraction*, but earns close to all of its revenues from operating a gas pipeline.

- has an immaterial ownership interest in an *exploration* license for a copper mine, but earns a significant amount of *extractives revenues* from refining crude oil into refined oil products.
- has insignificant interests in oil *extraction*, but earns close to all of its profits from operating a shipping business, for which most of the revenue is derived from service fees charged to transport third parties products.
- conducts *qualifying processing* with respect to copper concentrate, but most of the copper concentrate was purchased from a third party rather than being extracted by the Group.

1913. Finally, the first part of the definition of *qualifying extractives group* provides that the *exploration*, *development* or *extraction* activities can be performed directly or indirectly through an *extractives joint venture* or a *resource development agreement*. This means that the two limbs of the gateway test may be able to be satisfied by the direct engagement in *exploration*, *development* or *extraction* activities and direct generation of *extractives revenue*, or it may be able to be satisfied indirectly through a Group's interest in that activity and revenues i.e. through an *extractives joint venture* or a *resource development agreement*. This form of arrangement would not disqualify a Group from being treated as being engaged in *exploration*, *development* or *extraction* as a principal on its own account.

Development

1914. Subparagraph (b) sets out the term *development* which means the process of drilling, excavating, constructing and maintaining the facilities to conduct *exploration*, *extraction*, or *qualifying processing*, as well as the infrastructure supporting those facilities, decommissioning, site restoration or rehabilitation. This recognises that in order to extract an *extractive product* and/ or engage in *qualifying processing*, the *development* of *exploration* and *extraction* facilities is required, and as such is a central part of the *extractives* process. Likewise, decommissioning an *extraction* or processing plant and equipment and rehabilitating or restoring a site of *extraction* or *qualifying processing*, for example following the completion of operations in order to return the site to its natural state, is also a central part of these processes and may be a requirement of the government as a term of the licence. The *development* process is a prerequisite to the *extraction* process which adds significant value to the underlying *extractive product* and is uniquely tied to the source country's taxing rights.

Exploration

1915. Subparagraph (c) defines *exploration*. *Exploration* means the process of searching for and evaluating an *extractive product* resource deposit or reservoir. *Exploration* includes a range of activities to help determine the feasibility for commercial exploitation of a particular deposit or reservoir. The *exploration* process is aimed at determining whether there is in a particular location a resource of sufficient quality and quantity to make an *extraction* project commercially viable which includes the process of ascertaining the size of the discovery and apprising its physical characteristics. The *exploration* process is a prerequisite to the *extraction* process which adds significant value to the underlying *extractive product* and is uniquely tied to the source country's taxing rights, for example, where the source country taxes the resulting profits or gain derived from selling an *exploration* or *extraction* licence, the value of which is based on the findings of the *exploration* about resources located in that Jurisdiction.

1916. *Exploration* is a broad term and is designed to capture all *exploration* activities that are in connection with searching for and evaluating an *extractive product*. This includes, but is not limited to, aerial surveys, geophysical surveys, geological studies, environmental assessment, core testing, the drilling of test wells and excavation of sample pits (chemical composition of the resource). *Exploration* also includes any related work associated with the evaluation on the commercial viability of the project including

by not limited to conceptual designs, feasibility studies, economic modelling and front-end engineering design or equivalent.

Extraction

1917. Subparagraph (d) defines *extraction*, which means the removal of *extractive products* from their natural site or mine tailings. The definition focuses on the activities of obtaining a saleable product from the *extractive product*.

1918. The definition is limited to an *extractive product*, discussed below. The reference to the removal of *extractive products* from mine tailings confirms that the exclusion applies in cases where the initial material or by-product removed from the earth is stockpiled/ stored, but where it later becomes economically viable to extract the valuable material from that stockpile, mine tailing or store. This means that the *extraction* need not take place all at the same time immediately after the initial removal of the material from the earth.

1919. The definition also provides that it includes carbon capture utilisation and storage (CCUS) engaged in connection with such removal of *extractive products*. CCUS is the activity of capturing carbon dioxide, and either transforming it into another product (such as construction materials), or storing it. It necessarily includes the transportation necessary to move the carbon dioxide to the storage location.

1920. CCUS activities would be part of the definition of *extraction* only to the extent they are conducted in connection with the Group's removal of *extractive products* from their natural site or mine tailings. It is only included to the extent it is incidental to the main definition, in the context of *extractives activity*; and as such it would not extend to standalone CCUS services, or those conducted in connection with later stage industrial processes. See also discussion of CCUS in connection with the definition of "qualifying processing".

Extractive product

1921. Subparagraph (e) defines *extractive product*. The definition of *extractive product* appears as part of the definitions of *exploration*, *extraction*, *qualifying processing*, *qualifying transportation*, and in the definition of *extractives revenue*.

1922. The concept of an *extractive product* is a non-renewable, tangible item / product that naturally occurs in, and is extracted from the Earth's crust. The reference to "naturally occurs in" means that it cannot be synthetic or manmade. The reference in the definition to items removed from the Earth's crust means that the exclusion does not extend to renewable resources, such as solar, water or wind. This also creates parity of outcomes, given that the revenue from such activities is the selling of power, which is not excluded even when based on an *extractive product*.

1923. The definition of *extractive product* refers to a solid, liquid or gas that is extracted from the Earth's crust. The definition further provides that the item/ product is in the form in which it exists upon its recovery or severance from its natural state i.e. it has not undergone any significant processing or changes from the original product that is extracted. This language distinguishes an *extractive product* from a later-stage product that has undergone alteration by virtue of additional processing activities (but which may be covered by the definition of *qualifying processing*).

1924. Finally, the last part of the definition notes that it includes a *mineral*, *mineraloid* and *hydrocarbon* (each of which are defined), as well as and similar materials extracted from the earth's crust. This could include, for example, noble gases that are extracted as a by-product in extracting natural gas.

Extractives activity

1925. Subparagraph (f) defines *extractives activity*. This term encompasses all activities that are part of the extractives value chain, drawing the line based on those activities that are closely tied to the source country's non-renewable natural resources and therefore reflect the source country's unique right to tax.

1926. The definition of *extractives activity* means *development, exploration, extraction, qualifying processing or qualifying transportation*. In using the language "or" it provides that it is one or more of these activities. This means that a Group need only be engaging in one of those types of activities to be able to generate *extractives revenues*. See also the discussion in paragraph 1900 and following of the definition of a *qualifying extractives group* and the requirement to be engaged in *exploration, development or extraction*.

Extractives asset

1927. Subparagraph (g) defines *extractives asset*. An *extractives asset* means (i) a license or right to explore for an *extractive product*; or (ii) an asset used in the conduct of an *extractives activity*.

1928. The inclusion of subdivision (i) is relevant because a Group may sell a license, or right or an interest in a licence, or a beneficial ownership interest in a licence, to explore or exploit an *extractive product*, and which could fall within subdivision (iv) of the definition of *extractives revenue*.

1929. Subdivision (ii) is relevant where a Group sells the facilities or infrastructure associated with the *exploration, extraction, qualifying processing, or qualifying transportation*, such as where it sold a pipeline, liquefaction facility, refinery, mine, railway, vessel, smelter etc.

Extractives joint venture

1930. The term *extractives joint venture* is defined in subparagraph (h). Given the capital-intensive nature of the extractives industry, the use of joint venture arrangements are common ways to share costs and risks. For example, it is common in the extractives sector for one joint venture party ("the operator") conducting the *extraction* on behalf of other joint venture parties. This means there would be partners in the joint venture that do not conduct the *extraction* themselves. Likewise, one joint venture party may be conducting the selling function to distribute the products on behalf of the other joint venture partners that are not directly engaged in that function. The operative effect of the definition is that the *extractives joint venture* partners can still be covered by the exclusion in all of these scenarios.

1931. The term *extractives joint venture* is distinct from the defined term joint venture which is used elsewhere in the Convention. It is designed to accommodate the wide range of structures that are present in the extractives industry. It means an arrangement, whether incorporated or unincorporated, whereby two or more enterprises participate jointly in *exploration, development or extraction*.

1932. The term "arrangement" refers to any form of agreement. The purpose of the arrangement in the context of the *extractives joint venture* definition is that two or more enterprises (whether they are Groups or not) participate jointly in the *exploration, development or extraction*. The definition does not set further conditions related to the relative size of the ownership or participation stakes in the joint venture. However, the first limb of the activities test in the definition of *qualifying extractives group* means that there must be a direct link through the form of equity interest to the *exploration, development or extraction*, and as a principal on its own account. Further, the "substantial connection" test described above guards against any risk of an interest in *exploration, development or extraction* leading to an inappropriately large exclusion for a Group.

1933. The definition explicitly confirms that it includes both incorporated and unincorporated arrangements. An incorporated joint venture means a joint venture between two or more Entities which is incorporated as a separate legal person. An unincorporated joint venture means a joint venture between two or more Entities which is not incorporated, but where the participants would typically set out in a contract the details of the arrangement, such as the respective roles to be performed and benefits to be shared.

1934. See discussion of the term *extractives revenue* for how the results from an *extractives joint venture* feature in the calculation of the exclusion.

Extractives revenue

1935. Subparagraph (i) defines the term *extractives revenue*, which has two operative roles. First, it appears in the second limb of the definition of *qualifying extractives group*. Second, it is used to determine the scope of the Convention and the profits of a *qualifying extractives group* that are excluded.

1936. The starting point for identifying the *extractives revenue* is the revenue reported in the entity financial statements (although the calculations required in paragraph 2 may then identify such revenues as reported in Consolidated Financial Statements or the relevant segment). The relevant financial statements are those of an Entity (or Entities) that are resident in, or a Taxable Presence that is located in, the Jurisdiction where the *extraction* takes place (the “Jurisdiction of *extraction*” as used in this Explanatory Statement). In this context, a Taxable Presence has to be determined without regard to the exclusion of an *extractives entity* from the definition of a Taxable Presence (see Article 2 Paragraph kk). That means that the exclusion can apply irrespective of whether the relevant revenues are earned through a separate entity or a permanent establishment.

1937. The Jurisdiction of *extraction* is the Jurisdiction where the *extraction* is undertaken. This means that the determination of the exclusion is by reference to the revenues booked in the Jurisdiction where the underlying *extractive product* is located and extracted. The language uses the phrase the “jurisdiction where *the extraction* is undertaken” (emphasis added). The significance of using “the” in this context is that the test is applied with respect to the relevant revenues in question. In other words, a Group earning revenues from selling iron ore will only be the Jurisdiction of *extraction* if the iron ore is extracted in that country. A Group selling iron ore, where it only has a copper mine in that country, would not be the Jurisdiction of *extraction* with respect to the revenues from iron ore. See also the discussion in paragraph 1998 below.

1938. In the event that a *qualifying extractives group* was engaged only in *exploration*, as is permitted in the first limb of the definition of *qualifying extractives group*, the Jurisdiction of *extraction* would be the Jurisdiction in which the *extraction* subsequent to that *exploration* would take place (or, if the *exploration* results are that *extraction* is not feasible, where the *extraction* would have taken place if it had been feasible to do so). In other words, the Jurisdiction of *extraction* would be the same as the Jurisdiction in which the *exploration* was taking place. As noted above in paragraph 1900, in order to benefit from the exclusion in Section 3, the revenue from the *exploration* must be booked in this Jurisdiction of *extraction*.

1939. In the event that a *qualifying extractives group* was only engaged in *development*, as is permitted in the first limb of the definition of *qualifying extractives group*, the Jurisdiction of *extraction* would be the Jurisdiction in which the *extraction* using those *development* assets would take place. If the *development* is in respect of an asset used to conduct *qualifying processing*, then the Jurisdiction of *extraction* would be the Jurisdiction in which the *extractive products* that are being processed in those facilities were extracted. For example, the building of a copper smelter in the same Jurisdiction as the one from which the copper was to be extracted would meet the Jurisdiction of *extraction* definition; whereas the building of an oil

refinery in a Jurisdiction that is not the one from which the oil being refined was extracted would not meet the definition. As noted above in paragraph 1900, in order to benefit from the exclusion in Section 3, the revenue from the *development* must be booked in this Jurisdiction of *extraction*.

1940. The definition of *extractives revenue* also makes provision for the results from an *extractives joint venture*. The *revenue* from an *extractives joint venture* will fall within the definition of *extractives revenue* (and therefore be excluded from the Convention) when it is reported by an entity or Taxable Presence that otherwise meets the rest of the definition of *extractives revenue* (i.e. the revenue is booked in the Jurisdiction of *extraction*). This language is added to confirm that the results of an extractive joint venture will form part of the mechanical calculations for the exclusion contained in paragraph 2, irrespective of whether the revenue is reported in the 'revenue' line item in the financial statements, or elsewhere in the financial statements.

1941. The following examples illustrate the application of the first part of the definition of *extractives revenue*.

1942. Example 1: Alumina (which is a product that is within the meaning of *qualifying processing*) is sold by a *qualifying extractives group* from Entity A (resident in Country A) to another Entity of the Group, Entity B (resident in Country B). Country A is the Jurisdiction of *extraction* in which Entity A mines the bauxite ore from which the alumina is produced. The revenue that is derived from the sale of the Alumina is within the definition of *extractives revenue*. The revenue booked from that sale as reported in the Entity A financial statements is used for the purpose of calculating the exclusion. That revenue is where the exclusion stops in respect of this Group, even though the alumina is an intermediate product at an earlier stage of processing than the maximum permitted by the definition of *qualifying processing* (i.e. given that aluminium, the resultant product from the processing of alumina, is still an excluded product). Country B engages in *qualifying processing* to produce aluminium. The revenue that is derived from the sale of the aluminium is not classified as *extractives revenue*, as it is not revenue reported in the Jurisdiction of *extraction* (which was Country A).

1943. Example 2: Alumina is sold by a *qualifying extractives group* from Entity A to Entity B, which are both members of the same *qualifying extractives group*. Both Entity A and Entity B are resident in Country A, the Jurisdiction of *extraction*. The revenue that is derived by Entity A for the sale of the Alumina to Entity B is *extractives revenue*, as Alumina is a product that falls within the definition of *qualifying processing* and is revenue that was reported in the financial statements of Entity A, which is resident in the Jurisdiction of *extraction*. Entity B engages in *qualifying processing* to produce aluminium that is then sold from Country A to Country X. The sale of the aluminium is classified as *extractives revenue* as it is a product that is within the definition of *qualifying processing* and the revenue was reported in the financial statements of Entity B, which is resident in the Jurisdiction of *extraction*.

1944. Example 3: Entity A is a member of a *qualifying extractives group* and is resident in Country A. Entity A extracts ore and produces copper concentrate in Country A, which is the Jurisdiction of *extraction*. It enters into a tolling arrangement with Entity B, which is located in a neighbouring Jurisdiction. Entity A provides Entity B with the copper concentrate, and Entity B processes it into a copper cathode and returns it to Entity A. Under the terms of the tolling arrangement, Entity A retains legal title to the copper, and no sale of the copper occurs from Entity A to Entity B. The resulting copper cathode is sold from the Country A, the Jurisdiction of *extraction*, and recorded as revenue in the financial accounts of the Entity A. The revenue from the sale of the copper cathode is *extractives revenue* as it is a product that is within the definition of *qualifying processing* and the revenue was reported in the financial statements of Entity A, which is resident in the Jurisdiction of *extraction*.

1945. The definition of *extractives revenue* also includes provisions relating to the type of revenue. This must be read in conjunction with the first part of the definition, referring to the revenue reported in the Jurisdiction of *extraction*. This means that the exclusion does not necessarily extend to all revenue booked by entities that are part of a *qualifying extractives group* and resident in the Jurisdiction of *extraction*; nor does it extend to all revenue that relates to *extractives activity*, wherever reported.

1946. There are three subparagraphs that define the type of revenue that is within the meaning of *extractives revenue*.

1947. Subdivision (i) refers to revenue from *extractives activity*. *Extractives activity* is defined as discussed above and covers the core activity that is carried on by a *qualifying extractives group* and that is excluded, being *exploration*, *development*, *extraction*, *qualifying processing* and *qualifying transportation*.

1948. For example, revenue derived from *exploration* and *development* would include any service fees earned for engaging in the *exploration* or building the relevant facilities and infrastructure on behalf of co-venturers, or from sales of *exploration* assets or licenses where they are not considered capital in nature (although, in most cases, *exploration* and *development* are likely to be costs rather than a source of revenue for a *qualifying extractives group*, or would fall within the definition of *extractives asset*, discussed below). Revenue from *extraction* and *qualifying processing* would generally be the revenue earned for selling the resultant product that the Group has produced.

1949. Revenue from *qualifying transportation*, when it is cross-border transportation, will fall within the definition of *extractives revenue* provided that it is reported in the financial statements of the Entity or Taxable Presence located in the Jurisdiction of *extraction*. That is, even though the transportation is performed outside the Jurisdiction of *extraction*, the definition looks to where the revenue is booked.

1950. For example, if an Entity resident in the Jurisdiction of *extraction* sells an excluded product cross-border to another party on a CIF basis (as per INCOTERMS), the revenue received by the seller is for the product and for the required transportation, and both of which fall within the definition of *extractives revenue* (being both booked in the Jurisdiction of *extraction* and from *extractives activity*). However, if the Entity resident in the Jurisdiction of *extraction* sells the product to a related party abroad on a “free on board” basis (where the buyer organises the transportation), and then the related party on-sells the product to an independent third party on a “cost insurance and freight” basis, the revenue earned by the related party (including the portion relating to transportation) is not considered *extractives revenue* since the related party is not resident in the Jurisdiction of *extraction*.

1951. Subdivision (ii) relates to revenue from selling *extractive products* and products that result from *qualifying processing*. This is different to the revenue that would be earned from *extraction* and *qualifying processing* that is covered by subdivision (i). That is because in subdivision (ii) the reference is intended to cover sales of such products that do not directly result from the Group’s own *extraction* and *qualifying processing*. Rather, this permits a degree of selling and trading of third-party products to the extent it is sourced from the Jurisdiction of *extraction*.

1952. However, the revenues that will fall within the exclusion from this selling and trading of third-party products is subject to three limitations. First, the language in subdivision (ii) provides that this is limited by reference to selling and trading of products that are of the same type that are produced in the course of carrying out the Group’s own *extraction* and *qualifying processing*. This ensures that the selling and trading is related to the Group’s core business, rather than an exclusion of an unrelated business. For example, if the Group extracts and sells crude oil, subdivision (ii) would permit the revenue from trading third party

crude oil to be excluded. However, if the Group extracts only crude oil, then a business in trading third party copper would not be excluded.

1953. A further example of the application of the definition is as follows. Company A is an Entity that produces LNG from natural gas that does not extract the natural gas but purchases it from Company B (that is an unrelated party). The *extraction* and processing into LNG both occur within the same Jurisdiction. Company A sells the resulting LNG cross-border after engaging in the *qualifying processing*. Company A satisfies the *qualifying processing* definition, but fails the *extractives revenue* definition. The natural gas used to produce the LNG was not extracted by the Group that comprises Company A, and was not the type of product that is produced in the course of carrying out the Group's *extraction* (as the Group does not engage in the *extraction*) thus failing the second element of subdivision (ii). Company A is also not a *qualifying extractives group* as it does not derive *extractives revenue* that has a substantial connection to the *exploration, development or extraction*.

1954. The second limitation is the requirement related to the revenue being reported in the Jurisdiction of *extraction*. This means that the revenue from a trading hub that is located outside the Jurisdiction of any of the Group's own *extraction* sites would not be excluded from the scope of the Convention, irrespective of whether it was selling and trading products that are of the same kind as the Group generally produces.

1955. The third limitation is the "substantial connection" test, referred to in the definition of a *qualifying extractives group*. A Group that conducts *qualifying processing* in the Jurisdiction of *extraction*, but which purchased the *extractive product* inputs from third parties which have engaged in the *extraction* in that Jurisdiction, would not be a *qualifying extractives group* where it had only a nominal interest in *exploration, development or extraction*.

1956. Subdivision (iii) relates to gain or loss from derivative instruments used to manage risks associated with activities described in subdivision (i) or (ii). Given the volatility in prices for *extractive products* and products resulting from *qualifying processing* that reflects broader macroeconomic factors and global issues beyond a Group's control, using derivatives such as price hedges is central to managing risk for the Group. Similar to the requirement under paragraph 3(n)(ii) the derivative instruments are limited to the products that are of the same type that are produced in the course of carrying out the Group's own *extraction* and *qualifying processing*. This ensures that the derivative instruments undertaken by the group to manage any risks relates to the Group's core business. Importantly, the derivative instruments need to be entered for risk management purposes only i.e. to fix a future price of a commodity as opposed to entering into speculative derivative instruments i.e. taking a position on future movements in commodity prices. For example, if the Group extracts and sells copper, subdivision (iii) would permit the gain or loss from derivative instruments associated with managing the risks applicable to its copper business to be excluded. Such gain or loss that is derived from these instruments would fall within the definition of *extractives revenue*, provided that it is reported in the financial statements in the Jurisdiction of *extraction*.

1957. Subdivision (iv) refers to the sale of *extractives assets* held in the course of carrying out the Group's *extractives activity*. "Extractives asset" is a defined term, discussed below. The language in subdivision (iv) is intended to be applied broadly to include a sale of a part interest in such an asset.

1958. The reference to the asset being held in the course of carrying out the Group's *extractives activity* means that it must be connected to the *exploration, development, extraction, qualifying processing or qualifying transportation* that the Group has itself carried out. This means, for example, that revenue derived by a Group that is in the business of selling infrastructure or trading in *extraction* licenses, without itself being engaged in operating the infrastructure or using the licence, would not qualify as *extractives revenue*. In addition, as is the case for all types of *extractives revenue*, the sale of the asset must be reported in the financial statements of the Entity resident in or Taxable Presence located in the Jurisdiction

of *extraction*. The same would be true of any subsequent adjustments to the gains or losses from the disposition. The Jurisdiction of *extraction* in this context means the Jurisdiction where the *extraction* relevant to the *extractives asset* took place. For example, in the case of a sale of a pipeline used to transport the crude oil from its *extraction* site, the pipeline would be located in the Jurisdiction of *extraction*. For example, in the case of the sale of an oil refinery, the Jurisdiction of *extraction* test means that the oil refinery must be located in a Jurisdiction in which the Group also extracts oil (irrespective of whether the refinery also processes oil obtained outside the Jurisdiction of *extraction*). This means that the sale of an oil refinery located in a Jurisdiction in which the Group does not engage in any *extraction* of oil would not qualify as *extractives revenue*.

1959. The definition also contains provisions that apply where the processing of a product takes place inside one Entity, but beyond the point which would be set by the definition of *qualifying processing*. This could apply, for example, where an Entity extracts and processes lithium (which is an *extractive product*) and uses it in manufacturing a lithium battery. In such a case, there is no revenue reported in the financial statements of the Entity that aligns with the scope of the exclusion. In such cases, the rule operates to provide a deemed revenue amount for the purpose of the ensuring that the exclusion can still apply to the earlier part of the product, but does not apply beyond the ordinary definition. The rule provides that, notwithstanding the revenues in the financial statements, the *extractives revenues* are calculated as if an arm's length sale of the product had taken place at the point that the *qualifying processing* was completed and before any additional processing occurred. In the lithium example described above, the *extractives revenue* would be calculated at the point that lithium carbonate or lithium hydroxide is produced, which is the last point in that production process that it would have met the definition of *qualifying processing*. Any intermediary product sold prior to this point such as the spodumene ore or spodumene concentrate would also be subject to the exclusion. Where an *extractive product* proceeded directly to a point that was beyond the definition of *qualifying processing* within one Entity, this rule would apply to determine the *extractives revenue* at last point which still fell within the exclusion.

1960. The arm's length price for purposes of this deemed sale should be calculated by hypothesising that the part of the Entity that conducts the *qualifying processing* (together with any prior *extractives activity*) and the part of the Entity that conducts the additional processing are separate and independent, or distinct and separate, from one another. This separates the Entity into two: all of the activities that took place up to and including the point of the *qualifying processing*; and everything thereafter. The arm's length price is the price such separate and independent, or distinct and separate, enterprises might be expected to earn under the same or similar conditions. This analysis should be performed by applying the principles underlying either Article 7 (Business Profits) of the OECD Model and its Commentary, or Article 7 (Business Profits) of the UN Model and its Commentary. The reference to applying the principles underlying those Business Profits articles is necessary because both articles are predicated on an enterprise that is resident in one Jurisdiction having a permanent establishment in another Jurisdiction. This differs from the scenario that applies where an Entity conducts both *qualifying processing* and additional processing in the same Jurisdiction (i.e. the Jurisdiction of *extraction*), which means direct application of either Article 7 is not possible. Rather, it is the principles of conducting the analysis that applies.

1961. The definition further provides that either Article 7 (Business Profits) of the OECD Model, or Article 7 (Business Profits) of the UN Model should be applied to calculate the arm's length price on the deemed sale at the point of completion of the *qualifying processing*. This provides a specific point of reference to be applied in this situation. The Article 7 used in bilateral tax treaties would not be applicable here, given there is no actual transaction and no cross-border issue to which such a treaty could apply. The use of "or" provides flexibility such that either of these model articles can be utilised. It would be for the implementing Jurisdiction's domestic legislation to specify which model ought to be applied.

Hydrocarbon

1962. Subparagraph (j) defines *hydrocarbon*. The term *hydrocarbon* refers to an organic chemical compound that is composed predominantly of hydrogen and carbon atoms. *Hydrocarbons* occur naturally and are non-renewable. They originate from plant and animal fossils that were formed by geological processes, such as the forces of temperature and weight over millennia. They are mostly found deep underground, in porous rock formations, such as sandstone, limestone, and shale. Porous rock formations are often found in large bodies of water, so there is an immense quantity of *hydrocarbons* trapped deep beneath the oceans.

1963. The definition includes a non-exhaustive list of the most common types of *hydrocarbons* which are oil sands, heavy and light crude oil, condensate and natural gas. These products are derived from various forms such as deposits forming deep underground including under water and subsurface oil and gas reservoirs or loose sand or partially consolidated sandstone containing bitumen.

1964. The reference to “stockpile” means the *extractive product* is still a *hydrocarbon* even if it has undergone some form of stockpiling or storage for various commercial reasons. The mere fact that the *hydrocarbon* has been stockpiled or stored does not change the chemical composition of the underlying product hence it is still an *extractive product*. The *hydrocarbon* does not have to be sold within a defined time after the *extraction* for the exclusion to still apply.

Mineral

1965. Subparagraph (k) defines *mineral*. A *mineral* is a naturally occurring, non-renewable, inorganic substance, which was formed by or subjected to a geological process such as temperature and pressure. The definition adds that it may be in or on the earth’s crust or in or under water, in order to confirm that the location of the *mineral* is not determinative.

1966. A *mineral* exhibits crystalline characteristics (meaning that the atoms and molecules are organised in a lattice pattern), as distinct from a *mineraloid* which exhibits non-crystalline characteristics. A *mineral* must also be in solid form, as opposed to being a liquid or gas. A *mineral* has a definite chemical composition meaning that all occurrences of a *mineral* have a defined chemical composition, but it can vary within a limited range.

1967. The definition further provides that a *mineral* may be found in an ore body, ore deposit, or in a stockpile or tailings. This is to confirm that the *mineral* does not have to be sold within a short time period of the *extraction* in order to be covered by the exclusion. *Minerals* that are extracted can be stockpiled for a period and sold later. For the avoidance of doubt this also applies to tailings to the extent that it is sold at any period after the *extraction* process.

1968. Finally, the definition includes a non-exhaustive list of the most common types of *minerals*, which are clay, gems, gravel, metal, ore, rock, sand, soil, stone, and salt.

Mineraloid

1969. Subparagraph (l) defines *mineraloid*. A *mineraloid* is a naturally occurring, non-renewable, organic substance that was formed by or subjected to a geological process such as temperature and pressure. The definition adds that it may be in or on the earth’s crust or in or under water, in order to confirm that the location of the *mineraloid* is not determinative. A *mineraloid* cannot be synthetic or manmade and is solely focused on naturally occurring products.

1970. The main differences between a *mineraloid* and a *mineral* is that the former exhibits non-crystalline characteristics, the internal atomic structure is not ordered due to its organic properties and may be in solid, liquid or gaseous form.

1971. The definition further provides that a *mineraloid* may be found in an ore body, ore deposit, or in a stockpile or tailings. This is to confirm that the *mineraloid* does not have to be sold within a short time period of the *extraction* in order to be covered by the exclusion. *Mineraloids* that are extracted can be stockpiled for a period and sold later. For the avoidance of doubt this also applies to tailings to the extent that it is sold at any period after the *extraction* process.

1972. Finally, the definition includes a non-exhaustive list of the most common types of *mineraloids*, which are amber, coal, obsidian and opals. A *mineraloid* for the purpose of the definition does not include water.

Qualifying processing

1973. The term “qualifying processing” is defined in subparagraph (m). It is used as part of the definition of *extractives activity*. This means that for a *qualifying extractives group*, the revenues from *qualifying processing* can be included as *extractives revenues*, and ultimately the profits from *qualifying processing* can be excluded from the scope of the Convention.

1974. This recognises that Groups involved in the extractives industry generally do not sell the *extractive product* as it is found in the earth in its natural state and the raw *extractive product* generally has limited functionality and useability in that state. The Group extracts the *extractive product* to process it and produce a product that is useable and for which there is a market demand. In some cases, it is only after a degree of processing that the Group can and will sell the product, and therefore this may be the first point at which the jurisdiction where the *extraction* takes place (referred to as the “Jurisdiction of *extraction*”) can effectively exercise its taxing rights.

1975. At the same time, it is necessary to provide a limit on the extent of processing that constitutes *qualifying processing*; otherwise a vertically integrated Group with an extractives business would be able to claim an exclusion for its resulting products that a manufacturing, power generation or consumer products group could not. The definition of *qualifying processing* identifies this delineation point in the value chain, which may be different for different originating *extractive products*. The underlying design principle is that it is this type of processing that creates a standardised, homogenous, fungible and sellable product. This is the point at which the product retains its particular characteristics as being directly derived from the *extractive product*, and is therefore closely associated with the Jurisdiction of *extraction*.

1976. There are three elements to the definition. First, it is defined by reference to a principle; then supplemented by a positive list of products which are captured under the term *qualifying processing*; and third a negative list.

1977. The principle is one of general application, and is relevant for determining the extent of the exclusion where a Group creates a product that is not otherwise contained in the positive list or negative list. As the principle has informed the development of the positive and negative list, where a Group has revenue from a product on the positive list, it need not separately prove how the general principle applies to that product. Likewise, if a product is on the negative list, there is no scope to argue that the product nonetheless falls within the general principle.

1978. The general principle is in two parts. The first part of the general principle refers to processing undertaken to concentrate, isolate, purify, refine, blend, separate or liberate an *extractive product* from its

natural state. These terms reflect a common concept which is to remove impurities and/or enhance the quality of the *extractive product* in order to make it fit for purpose, useable, transportable and sellable. These processes include the application of temperature, the use of distillation processes, washing and grinding, smelting, acidic bath, electrolysis, and the addition of chemical solutions and catalysts in order to facilitate the separation of the *extractive product* into its constituent parts. Several of these types of processes may be applied in succession to fully liberate the extractive material, and the definition does not require that only one type of such process can be used. The general principle also refers to carbon capture utilisation and storage, which is discussed below at paragraph 2002.

1979. The second part of the general principle appears after the positive list, and is used to identify the types of processing and other activities that create products that are not excluded. That part of the principle refers to processing that involves combining two or more other products; extrusion; fabrication; manufacturing or transforming. These terms reflect a common concept which is the creation of a separate and new product that is distinct from and of a different nature to the *extractive product* from which it derives. This recognises that further conversion of the underlying *extractive product* into a different product makes it further removed from the specificities of the Jurisdiction of *extraction* and its unique right to taxing its natural resources, because after this point the process is more akin to the manufacturing of products that do not obviously reflect their origin as an *extractive product*. For example, copper cathode is pure copper and the primary raw material input to produce copper wire and cable and that copper cathode is therefore excluded from the scope of the Convention, while on the other hand the copper wire and cable is the transformation of the basic copper into a new type of product and is not excluded.

1980. The reference to “blend” in the first part of the general principle is distinct from the later reference to “combining two or more other products”. The term “blend” means to mix different batches of the same basic product, albeit of different qualities, in order to adjust the overall quality of the resulting product. This is usually performed to derive a stable, consistent, and uniform product to the market. The blending process does not create a new product as it is purely adjusting the composition of the same product. This would include, for example, blending two batches of copper concentrate, one with a certain amount of impurities and the other with fewer impurities, in order that the resulting blend meets the necessary specification as it relates to impurities. Another example is iron ore blending which can involve iron ore from different or the same mines with differing levels of iron content or impurities being blended to achieve a uniform and consistent product. The resulting product is still iron ore, and no new product is created.

1981. On the other hand, the reference to “combining two or more other products” refers to separate, different products that are then added together, with the result that a third, new type of product being created. For example, steel is created by combining iron ore and carbon where the result (the steel) is fundamentally of a different nature to the iron ore and the carbon. An example in relation to *hydrocarbons* is where, after the crude oil distillation process, the resulting products are combined via chemical or molecular bonding, such as in the process used to create alkylate. This is within the meaning of “combining two or more other products” because the underlying products are chemically converted to form a different product. However, the mere fact of using another element or product in the production process does not necessarily mean that such products are combined. For example, using water to wash ore or coal is not combining two or more products, because the water does not combine (or blend, for that matter) with the ore or coal to form a third product.

1982. In assessing whether a product not otherwise contained on the positive list or negative list in the definition falls between blending and combining, the analysis looks to the following. Products that are the result of blending will be those where:

- the purpose of the processing is to adjust the quality of the underlying product to achieve a uniform and stable output;

- the role of any external products is to facilitate the processing (e.g. to stimulate the cleaning or solidification process) as opposed to combining those external products as something that is incorporated into the resulting product; or
- the resulting product remains identifiable (in terms of basic chemical composition or as marketed to customers) as the same type of product as before the processing.

1983. Products that are the result of combining will be those where:

- the purpose of the processing is to create a new, separately identifiable product (in terms of basic chemical composition or as marketed to customers);
- the role of external products is to be joined or added together as enduring, component parts of the resulting product; or
- the resulting product is separately identifiable (in terms of basic chemical composition or as marketed to customers) compared to before the processing.

1984. In particular, some metal alloys will fall between the concept of blending and combining. A metal alloy would be excluded from the scope of the Convention where it is fundamentally about the purification of the basic input (for example, the addition of the same product) but where that product is still identifiable as the same type of product. Aluminium is the final stage of the bauxite / alumina / aluminium value chain before it undergoes fabrication, extrusion and/or manufacturing to produce a different product. Aluminium is generally produced via electrolysis from alumina and through this process other metals may be used – purely in the production process. Aluminium is an example that may have other metals used in the production process, however, the product still retains its core physical properties as aluminium. That is, the metals added to aluminium during this stage do not give rise to a new product nor change the underlying nature of the product that is being produced, being that of aluminium. On the other hand, a metal alloy could be included in the scope of the Convention because it is fundamentally about creating a new product by combining two or more metallic elements that are component parts often to give greater strength or resistance to corrosion to create a new, separately identifiable, chemically changed or differently marketed type of product (for example the creation of white gold (through the combination of the two different products, gold and silver) or the creation of sterling silver (through the combination of the two different products, silver and copper) that is then used in the creation of jewellery. The determinant is not the relative amounts of additives. For example, in creating steel, the inputs are approximately 98 per cent iron ore and 2 per cent carbon. Although the vast majority of the inputs are iron ore, the resulting product is of a different kind, and therefore steel is an example of a metal alloy that is included in the scope of the Convention.

1985. Another example of the difference between blending as opposed to combining to create a new product is in the concrete value chain. The *extractive product* is generally the limestone (which is extracted alongside other raw materials); the *qualifying processing* is the crushing, screening of the materials, and heating to create clinker (which is the *extractive product* brought to a uniform blend). Separately, the creation of the cement results from the combining of the clinker with gypsum. By adding this additional product i.e. the gypsum, the cement is a separate, identifiable product as distinct from the clinker and is not excluded. As such, the exclusion stops at the clinker and gypsum stage. To complete the value chain the resulting cement is then combined with aggregates (stone, gravel and sand) to create concrete by adding water – this is another example of two or more products being combined to create a new product and it will not form part of the exclusion.

1986. A further example relates to diamonds with the rough diamond that is extracted from the earth's crust being an *extractive product* that is covered under the exclusion. The later stage of the diamond value

chain involves the cutting and polishing of the rough diamond in which the rough diamond is liberated. The exclusion will apply to the polished diamond as it is fundamentally the same product as the original rough diamond that was extracted i.e., the chemical composition is the same, no two products are combined to form another product, therefore it is covered by the exclusion.

1987. The positive list is contained in subparagraph (m)(i) and (ii) and is not exhaustive. In applying the rules, Groups should apply the list by analogy to similar products where relevant. The positive list sets out common examples of products that are intended to be excluded as they result from *qualifying processing*.

1988. Subdivision (i) relates to those products that are the end point of *qualifying processing* for purposes of the Convention. The first set of products on the list are those that derive from *hydrocarbons* are liquefied natural gas (LNG), liquefied petroleum gas (LPG) and other natural gas liquids, diesel, kerosene, gasoline, and hydrogen. These products are those that result from the refining of the *hydrocarbon*, such as by crude oil refining, natural gas liquification and natural gas liquid production.

1989. Oil refining fits with a definition of *qualifying processing* in that it generally involves isolating the crude oil into inherent components through processes like distillation, as opposed to additive processes. The crude oil distillation process aims at separating the crude oil into broad categories of its component *hydrocarbons* with the crude oil being heated and then put into a distillation column where different products boil off and are recovered at different temperatures. Although crude oil can be sold in that form prior to the refining, a consistent application of the principle underlying *qualifying processing* leads to the conclusion that the refined crude oil products, such as diesel, kerosene and gasoline are also excluded products. These products are formed from the distillation process only and not subject to any material additives or additional processing. As an example, jet fuel is not excluded as the production process involves the addition of significant additives, however, naphtha is included as it is formed via the crude oil distillation process. Another example of a product that is not excluded because it is beyond the concept of refining (and is rather about combining two or more products) is the process to create alkylate, which is synthetically produced by chemically bonding excess gases from crude oil distillation and cracking facilities. However, light heating oil is included as *qualifying processing* to the extent it is formed via crude oil distillation process.

1990. The other products that appear on the positive list in subparagraph (m)(i) are those products that result from *qualifying processing* that derive from *minerals* and *mineraloids*. They are metal oxides, metal hydroxides, anodes, cathodes, cast metals and aluminium. Common examples of metals are aluminium, copper, nickel, iron, tin, gold, lead, platinum group metals, silver, manganese, cobalt, molybdenum, lithium carbonate/hydroxide, boric acid, titanium, uranium, and zinc, as well as metal oxides and metal hydroxides. Examples of an anode is copper and graphite anodes. Examples of metal cathodes are copper, cobalt and nickel cathodes. Aluminium results from *qualifying processing* as it is produced from alumina which is in turn produced from the *extractive product* bauxite. Aluminium is the final stage of the bauxite/ alumina value chain before it undergoes fabrication and/or manufacturing to produce a fundamentally different product. The exclusion does not extend to any products that are created from the aluminium through fabrication, extrusion and/or manufacturing such as the aluminium sheets or inputs into construction or car manufacturing.

1991. The products listed on subparagraph (m)(i) of the positive list are those that are the final step of the production process that still meets the definition of *qualifying processing* i.e. no further processing is possible without breaching the limit of the definition of *qualifying processing*, because further processing would require combining two or more other products, extrusion, fabrication, manufacturing, or transforming.

1992. However, it is possible that a Group could also sell products that are in a form prior to this final stage. For this reason, the positive list includes subparagraph (m)(ii) which provides that the definition of

qualifying processing also covers all processing undertaken to produce all products obtained from an *extractive product* before they become the products listed in subdivision (i) (referred to as “intermediate products”). This means that an intermediate product can also be a product that has undergone *qualifying processing*.

1993. As such, it is intended that even if a Group derives revenue from an intermediate product, that is still excluded, even if the product does not appear on the positive list because it sold it at an earlier stage in the production process. For example, bitumen produced from oil sands and its subsequent processing into light crude oil would qualify within the definition of *qualifying processing*, given that they are intermediate products between oil sands (a raw *extractive product*) and refined oil products like diesel and gasoline. Likewise, metal concentrates i.e. copper concentrate being an intermediate product that is an input into a metal anode and a metal cathode. The same is true of products such as bauxite, alumina and titanium oxide slag, as intermediate products that can also be excluded by virtue of the definition of *qualifying processing*.

1994. The negative list appears in the final phrase of the definition of *qualifying processing*. It provides a bright line set of examples that do not result from *qualifying processing* but are beyond *qualifying processing* and result from a later stage process, the result of which is not excluded. That negative list includes electricity, steel, jewellery, petrochemicals, chemicals, plastics and plastic polymers. These are all examples of products that have their origin from an *extractive product*, but are a fundamentally different product from the underlying natural resource, by virtue of the additional combining, extrusion, fabrication, manufacturing or transforming and similar processes that were applied. Transforming in this context is when the product is physically or chemically altered to the point where the resultant product has a different market or purpose i.e. the conversion of thermal coal into electrical energy.

1995. Like the positive list, the negative list is not exhaustive. In applying the rules, Groups should apply the list by analogy to similar products where relevant. Concrete is an example of such a product as it involves combining two or more products (i.e. cement is combined with aggregates (stone, gravel and sand) along with water to create concrete). In addition, where a product is itself comprised of a product on the negative list, then that product would also be likely to be not excluded. For example, a complex chemical comprised of several chemicals would not be excluded.

1996. The definition of *qualifying processing* is not restricted to processing of the Group’s own *extractive products*, in that the language refers to processing of “an *extractive product*” without specifying that it must be one extracted by the Group.

1997. This is relevant to blending, for example, where a Group may need to purchase a third party’s metal concentrate in order to blend with its own metal concentrate and meet the relevant product specification in order to reach a level of quality or consistency of the resulting product, such that it will have a market.

1998. In order to do so, it may be necessary to blend *extractive products* that are sourced from a Jurisdiction other than the Jurisdiction of *extraction*. If an *extractive product* that is used in the blending process is sourced from another country, and blended with an *extractive product* from the Jurisdiction of *extraction*, then provided the blending takes place in that Jurisdiction of *extraction*, the exclusion will continue to apply to the resulting blended product (provided it still otherwise meets the definition of *qualifying processing*).

1999. For example, Group A in Country A has a copper mine facility that extracts ore and produces copper concentrate. In addition, Group A buys copper concentrate from Group B in Country B. The copper concentrates sourced from Country A and B are blended together to form a uniform blend, which then

undergoes *qualifying processing* in Country A, in a smelter operated by Group A, to create the copper cathode. The copper cathode that is produced by Country A as result of the blending of copper concentrate that is sourced from both Country A and B will meet the definition of *qualifying processing*, as well as the Jurisdiction of *extraction* test within the definition of *extractives revenue*.

2000. The application of the definition of *qualifying processing* to an *extractive product* that is not the Group's own *extractive product* is also relevant, for example, when a Group performs some processing for a fee, without taking title to the product. This is common when a Group has built a mine and a smelter to serve it. As the mine output falls as the deposit is depleted, the firm can offer the excess capacity in the smelter by agreeing to process materials from third parties for a fee. This would still be *qualifying processing*, because this type of activity is within the definition of *qualifying processing* (see paragraph 1978).

2001. However, other elements of the rules prevent the exclusion from being applied to a Group that was only, or even primarily, performing processing services with respect to third party *extractive products*. That includes the test for a *qualifying extractives group*, which requires that the Group is engaged in the *exploration, development* or *extraction* (and not the processing only). Further, the "substantial connection" test in the definition of *qualifying extractives group* would prevent a Group that was deriving substantial revenue from processing that was not related to its own *exploration, development* or *extraction*. Finally, the definition of *extractives revenue* provides limits on the exclusion in respect of products that are not produced by the Group's own *extraction* and *qualifying processing* activities and are not reported as revenues in the Jurisdiction of *extraction*.

2002. Finally, the definition of *qualifying processing* includes Carbon Capture Utilisation and Storage (CCUS). This activity is part of *qualifying processing* (and therefore part of *extractives activity*) when it is conducted in direct connection with the attainment of products that result from *qualifying processing*. This would include, for example, CCUS conducted in the course of operating an oil refinery used to refine crude oil into gasoline. Given that carbon capture storage is an activity that is connected to the processing of the *extractive product*, but may not be completed immediately after the processing. The exclusion would include storage in connection with resource deposits (including the associated processing) that are no longer active and producing. CCUS would also include the associated transport of the captured carbon from the site of capture to the site of storage.

2003. The limitation to CCUS to that undertaken in connection with the *qualifying processing* means that it would not include CCUS conducted in connection with later-stage production activities that are otherwise beyond the scope of the exclusion, such as those in connection with the production of electricity. Likewise, it would not include CCUS conducted in connection with combustion of biofuels, for example, given that would not be in connection with *qualifying processing* (which in turn is limited to the processing of non-renewable *extractive products*). It would also not include the production of new products from the captured carbon dioxide (such as building materials).

2004. The inclusion of CCUS within the definition of *qualifying processing* is chiefly relevant as a cost that would be associated with extractives expense. However, there may be revenue associated with CCUS (such as revenue from trading carbon emissions permits). Provided such costs and revenue are in connection with processing, those costs and revenue would be covered by the exclusion.

Qualifying transportation

2005. Subparagraph (n) defines *qualifying transportation*. This is used as part of the definition of *extractives activity*. This means that for a *qualifying extractives group*, the revenues from *qualifying*

transportation are included as *extractives revenues*, and ultimately the profits from *qualifying transportation* can be excluded from the scope of the Convention.

2006. Transportation is an integral part of an extractives business. Given the location of an *extractive product* (which may be in remote areas or under water, for example), the ability of the Group to move the *extractive product* to a location suitable for further processing, and to transport it to the customer, is a core aspect of the business. It is also, in many cases, a unique kind of transportation, specifically reflecting the nature of the underlying *extractive product*. For example, specific types of transportation are needed to transport natural gas or heavy crude oil, and to do so safely. In addition, *qualifying extractives groups* may sell their products on terms that are inclusive of transportation. This means it can be difficult to split the revenue between the product and transportation, and the inclusion of these revenues in the scope of the exclusion alongside the sale of the product avoids the need for complex allocations.

2007. The definition of *qualifying transportation* means the physical movement and storage of an *extractive product* or a product resulting from *qualifying processing*, including by air, land or sea. This includes modes of transport such as vehicles, vessels, aircraft and pipelines (both on land or sea).

2008. It covers the transportation of all types of products that are otherwise covered by the exclusion, as defined by the terms *extractive product* and *qualifying processing*. This also means that transportation of a later stage product, such as steel or petrochemicals would not fall within the definition of *qualifying transportation*. In referring to the products being transported, the definition does not specify that the products must only be those owned or sold by the *qualifying extractives group*. This means that revenue from *qualifying transportation* is excluded in respect of a *qualifying extractives group* even where the transport is provided as a service to another Group – typically referred to as co-mingling. Provided that the Group is itself a *qualifying extractives group* (including that its revenues meet the “substantial connection” test described in that definition), this additional revenue from providing transportation services is still excluded. This means that a Group that is only engaged in providing transportation, or is primarily providing transportation which is not related to its own *exploration, development* or *extraction* business would not have its transportation revenue or profits qualify for the exclusion.

2009. The definition further specifies that it includes insuring the products so transported. This is relevant when contracts for the sale of the products are on a “Cost, Insurance and Freight” (CIF) basis, where the seller is responsible for the insurance while the goods are in transit to the customer. This means that the seller, being the *qualifying extractives group*, receives an amount of insurance revenues as part of the sale price. This is a typical arrangement and is inherent to the provision of the transport itself, and is therefore a logical part of the exclusion as is the case for the underlying transportation. It can also be difficult to delineate insurance revenue from the other transportation revenue when contracts are on a CIF basis and the inclusion of the insurance as part of the definition of *qualifying transportation* avoids the need to do so.

2010. Finally, the definition of *qualifying transportation* includes revenues and expenses that are directly connected with the transportation. This includes, for example, demurrage, dispatch and bunkering. For the avoidance of doubt, it does not include notional expenses such as under-utilisation or deadweight.

Resource development agreement

2011. Subparagraph (o) provides a definition of a *resource development agreement*. As noted above, the first part of the definition of a *qualifying extractives group* provides that the activities engaged in, and resulting revenues derived, in connection with a *resource development agreement* by a Group are still covered by the exclusion, for the same reason as applies to an extractive joint venture. For example, in the oil and gas sector, it is common that the government of the Jurisdiction where the *extractive product* is located may not grant ownership to the underlying *hydrocarbons*, but may provide a contractual right to

the Group to develop and exploit the underlying resource. As a result, the Group is able to share in the resulting sales that are derived from the project (commonly called a production sharing contract, or a technical services contract). In these scenarios the Group may not own the resulting product, but it is engaged in the *exploration, development or extraction* for its own benefit and the benefit of the other parties and is entitled to a share of the economic rents that are derived from the project.

2012. The term *resource development agreement* is defined to be broad in nature and in a way that is intended to be inclusive of different arrangements across the extractive sector. The definition requires that the Group explore, develop and extract the *extractive product*, acting as contractor or concessionaire to the government, and not to a private or publicly owned entity.

2013. The concept is different to a contractor that is engaged to conduct a specific service or function. In substance, the effect of a *resource development agreement* is similar to as if the Group had an equity interest in the project and was carrying out the activities for its own benefit. The Group still bears considerable economic risks that are associated with an extractive project and shares in the corresponding upside and potential downside risks of the project. A contractor, on the other hand, earns service revenue for the performance of its functions and bears risk in relation to the performance of the services/ functions only. Consequently, the contractor is insulated from the underlying risks and successes of the extractive project itself i.e. market risk, price risk, resource availability risk, volume risk etc.

Taxable Presence

2014. Subparagraph (p) defines the term Taxable Presence. The term Taxable Presence is defined in Article 2 (gg).

Paragraph 4

Notification relating to definition of extractives revenue and extractives activity

2015. Paragraphs 4 through 6 provide the possibility for a Jurisdiction to provide a notification that modifies the definition of *extractives revenue* and *extractives activity*. This results in a Jurisdiction not claiming the full extent of the extractives exclusion provided in Annex C Section 3, and is provided for the purpose of facilitating simplified compliance with the rules.

2016. Paragraph 4 provides that a notification may be filed, that adjusts the definition of the term *qualifying processing*. This term is relevant for the purpose of determining the *extractives revenue* or *extractives activities* of a *qualifying extractives group*, which in turn governs the calculation of the *non-extractives adjusted revenues* and the *non-extractives pre-tax profit margin*.

2017. If the notification is made, the term “qualifying processing” is narrowed, such that the exclusion does not apply to processing undertaken to produce refined oil products such as diesel, kerosene, and gasoline. Typically, this would mean that the exclusion would stop at the point of crude oil, and not extend to the subsequent refining. This adjusted definition of *qualifying processing* then governs for all other purposes of the exclusion provisions contained in the Annex (for example, it would also affect the meaning of the defined term *extractives revenue*, in subparagraph (i)(ii)), and for the rest of the Convention (such as for the Adjusted Profit Before Tax and Elimination Profit (or Loss)).

2018. Paragraph 4(a) and (b) provide the conditions for making a notification. Both conditions must be met. First, in paragraph 4(a), it is (i) only applicable to Jurisdiction in which the processing undertaken to produce refined oil products such as diesel, kerosene and gasoline takes place. Second, in (ii), it is only applicable to Jurisdictions in which the resulting revenues from the oil refining processing would otherwise

meet the definition of *extractives revenue*. That means that the notification can only be made by a Jurisdiction of *extraction* in which oil refining also takes place.

2019. Paragraph 4(b) provides that in order to be effective, the notification must be made by all such Jurisdictions that meet the condition in paragraph 4(a) that are relevant to a particular *qualifying extractives group*, if they together constitute the majority. The majority means more than 50 per cent of the extractives revenues from the *extraction* and refining of oil, and is tested by assessing the total *extractives revenues* of the Group that derives from the *extraction* and refining of oil over the preceding three Periods. This means that if there is a Jurisdiction in which a *qualifying extractives group* extracts crude oil and conducts oil refining to produce products such as diesel, kerosene and gasoline and that does not make the notification, then the election would nevertheless be in effect with respect to that Jurisdiction (and all Jurisdictions) if Jurisdictions representing a majority of the Group's extractives revenues from the *extraction* and refining of oil over the preceding three Periods have made the notification. The majority revenue test does not take into account the *extractives revenues* that come from other *extractive products*, such as gas or *minerals*.

Paragraph 5 through 7

2020. Paragraph 5 provides that notifications may be made by a Party and can include one or more Jurisdictions for which it has made a declaration described in Article 42(1) with respect to all *qualifying extractives groups* at any time after the Entry into Force of the Convention. The first time that the notification is made, it would take effect for a Group with respect to the first Period ending on or after the date on which the notification is received by the Depositary. For example, if the notification was made in November 2030, and the Period for the *relevant group* ends on 31 December 2030, then the notification is in effect for the 2030 Period.

2021. Paragraph 6 provides that the notification can be revoked, in which case the definition of *qualifying processing* reverts to the definition contained in paragraph 3(m). However, the withdrawal shall take effect for a Group with respect to Periods ending on or after the later of: the date on which the notification of withdrawal is received by the Depositary; and the date that is three years after the date of the receipt of the notification that is being withdrawn. This means that once made, the application of the narrower definition of *qualifying processing* remains in place for at least the subsequent three years. If more than three years has elapsed since the previous notification, then the withdrawal takes effect from the date on which the notification is received, and for the Period ending on or after that date.

2022. Paragraph 7 provides that if a Party has withdrawn a notification pursuant to paragraph 6, it may not make another notification until three years after the later date referred to in paragraph 6. This means that the election applies with a degree of stability in both directions; once elected it remains in place for at least three years as per paragraph 6, and once reevoked it remains revoked for at least three years as per paragraph 7.

Paragraph 8

Exclusion of revenues and profits of a qualifying extractives group

2023. Paragraph 8 provides that the relevant replacement terms set out in that paragraph also apply to a Group that is not a *qualifying extractives group* in the current Period, but was a *qualifying extractives group* in a prior Period. This is necessary to ensure that the correct calculations are applied in the current Period, where they would be affected by the historical application of the rules for a *qualifying extractives group* for the prior Period.

2024. The effect of paragraph 8 is that for the purpose of applying the averaging rules in the current Period, the results of applying the extractives exclusion in the prior Period continue to affect the current calculations. In addition, it ensures that the extractives losses incurred in the prior Period cannot be used to offset against Amount A in the current Period.

2025. Subparagraph (a) replaces the term “pre-tax profit margin” in Article 3(2)(a) with the term “non-extractives pre-tax profit margin”. This excludes amounts derived from extractives from the calculation of the *pre-tax profit margin* in the Periods immediately preceding the Period. The term “non-extractives pre-tax profit margin” is defined in paragraph 2(x).

2026. Subparagraph (b) substitutes the term “non-extractives adjusted profit before tax” for the term Adjusted Profit Before Tax and subparagraph (c) replaces the term “Adjusted Revenues” with the term “non-extractives adjusted revenues” in Article 3(2)(b). These adjustments exclude amounts derived from extractives from the calculation in Article 3(2)(b). The term “non-extractives adjusted profit before tax” is defined in paragraph 2(l) and the term “non-extractives adjusted revenues” is defined in paragraph 2(m).

2027. Subparagraph (d) replaces the term “relevant net losses” with “non-extractives relevant net losses”. This ensures that losses in prior Periods that derive from extractives are not deducted from the Adjusted Profit Before Tax in the Period. The term “non-extractives relevant net losses” is defined in paragraph 2(y).

Section 4 – Application of this Convention to a disclosed segment

Paragraph 1

2028. Paragraph 1 provides the conditions to determine whether a *disclosed segment* is a *covered segment*. Read together with Article 3(6), it provides an exception to the general scope rules contained in Article 3, treating a *disclosed segment* that meets the revenue and profitability tests in Article 3 (as modified by Section 4) as a *covered segment* that is within the scope of the Convention, even though the Group as a whole (including a *qualifying extractives group* and a Group that conducts regulated financial services) is not a Covered Group. Except as provided in paragraph 2, it applies only to a Group that satisfies the revenue test but that does not satisfy the profitability test in Article 3.

2029. Paragraph 1(b) tests the *segment adjusted revenues* against the absolute monetary threshold of EUR 20 billion contained in Article 3(1)(a) and tests the *segment pre-tax profit margin* with the 10 per cent threshold in Article 3(1)(b) and, where applicable, Article 3(2). Given that both the segment revenue and segment profitability tests replicate the revenue and profitability tests in Article 3 for purposes of a *disclosed segment*, paragraphs 152 through 163 of the Explanatory Statement on Article 3(1) and (2) can be read for further guidance.

Paragraph 2

2030. Paragraph 2 provides a targeted and time-limited exception to the normal operation of the scope tests in Article 3(1) where a Group meets the conditions therein in certain prescribed circumstances and would otherwise be considered a Covered Group. This exception is referred to as the “transitional segment rule” and provides that, in certain circumstances, the Group is not a Covered Group for a Period but instead one or more *disclosed segments* of the Group are *covered segments*. It is designed to prevent a potentially counter-intuitive outcome as a result of the normal operation of the scope rules where, absent the transitional segment rule, the Amount A Profit determined under Article 2(d) that is available for allocation

under the Convention decreases from one Period to the next in the case that a highly profitable *covered segment* is no longer in scope because the Group itself comes into scope as a result of exceeding the profitability threshold (as absent the transitional segment rule, a *disclosed segment* can only be in scope under Section 4(1) if the Group is not because it fails the profitability test). In order to avoid such a counter-intuitive outcome in these limited circumstances, the transitional segment rule provides that the Group will not be in scope for a time-limited period and instead that a *disclosed segment* remains in scope subject to the conditions explained below.

2031. Firstly, this rule can only apply where the two pre-conditions in subparagraph (a) are met:

- the Group meets the conditions in Article 3(1) and, where relevant, Article(2) for a Period; and
- the Group was not a Covered Group in any prior Period.

2032. Secondly, the rule sets out four additional conditions in subparagraph (b)(i) through (iv) that must be satisfied for the rule to apply.

- Subdivision (i) – the *disclosed segment* meets the scope thresholds for the current Period. This means the rule will only apply provided that the *disclosed segment* meets the revenue test and profitability test as modified by Section 4 for the Period.
- Subdivision (ii) – the *disclosed segment* was a *covered segment* for at least both of the two Periods immediately preceding the Period in which the Group meets the conditions in Article 3(1) and, where relevant, Article 3(2), to ensure that the rule does not apply disproportionately to a case where a *disclosed segment* is a *covered segment* by exception (i.e. for one Period or multiple Periods that do not follow each other prior to the Group meeting the scope thresholds). This means, for example, that a *disclosed segment* that is a *covered segment* for three Periods immediately preceding that first Period, would meet this condition because it clearly was a *covered segment* for both of the two Periods immediately preceding that Period.
- Subdivision (iii) – the current Period falls within a five-year period of the Period where the Group would otherwise have been a Covered Group. This means the application of the rule is limited to five periods starting with the Period that immediately follows the first Period in which the Group meets the conditions in Article 3(1) and, where relevant, Article 3(2) (i.e. the same Period as referenced in subdivision (ii)). The five-year period can only start once and, after those five Periods, the rule cannot apply again.
- Subdivision (iv) – the Amount A Profit determined under Article 2(d) of would be lower if the Group was in scope for the Period, as compared to the Amount A Profit determined under that Article if the *disclosed segment* was in scope for the Period. This means the rule only applies in cases where it is necessary to avoid the counter-intuitive outcome mentioned above. The condition in subdivision (iv) is met if the amount of the *disclosed segment* that would be calculated under Article 2(d) for the current Period and each prior Period that falls within the five consecutive Periods referenced in subdivision (iii) exceeds the amount of the Group calculated under Article 2(d) in the Period and each respective prior Period. Where there is more than one *disclosed segment*, each *disclosed segment's* amount calculated under Article 2(d) is tested separately under this subdivision (i.e., there is no aggregation of the financial results of different *disclosed segments*).

2033. Where the outcome under paragraph 2 is that a Group is out-of-scope, as the conditions in subparagraphs (a) and (b) are met with respect to one or more of its *disclosed segments*, that outcome is determinative. This means that it is sufficient for one of the *disclosed segments* of the Group to be kept in

scope under paragraph 2, irrespective of whether the conditions in paragraph 2 are satisfied by a different *disclosed segment*. Hence, in the case that paragraph 2 does not apply in the case of a different *disclosed segment* (because that other *disclosed segment* does not meet the conditions in subparagraph (b)) and thereby that other *disclosed segment* is not held in scope, then the Group would not be brought back in-scope as a result of the other *disclosed segment* failing to meet the conditions in subparagraph (b). An illustration of the application of the transitional segment rule can be found below.

Box 30. Examples – Application of the transitional segment rule in time

Example 1

Period 2025

A multinational enterprise, Group A, meets the revenue and profitability tests in Article 3(1) and (2) for the first time in Period 2025 and was thus not a Covered Group in any prior Period. Group A reports two *disclosed segments* (*disclosed segment A* and *disclosed segment B*) in its consolidated financial statements and *disclosed segment A* was a *covered segment* for Periods 2023 and 2024. As Group A meets the two pre-conditions of the transitional segment rule in paragraph 2(a) in 2025, it is necessary to consider the four conditions in subparagraph (b)(i) through (iv).

- Subdivision (i): Based on Group A's Consolidated Financial Statements, *disclosed segment A* meets both the segment revenue test and the segment profitability test and therefore satisfies this subdivision. As *disclosed segment B* does not meet these tests in 2025, the transitional segment rule does not apply to it for 2025 and there is no need to consider the other subdivisions.
- Subdivision (ii): This condition is met for *disclosed segment A* because it was a *covered segment* under Section 4(1) in the two Periods immediately preceding the Period where the Group first meets the conditions in Article 3(1) and (2): 2025.
- Subdivision (iii): This condition is met because Period 2025 falls within 2025 – 2029 (i.e. the five consecutive Periods that begin with Period 2025).
- Subdivision (iv): Based on Group A's Consolidated Financial Statements, the Amount A Profit of *disclosed segment A* calculated under Article 2(d) for 2025 is higher than the amount the Group that would be calculated under Article 2(d) for 2025 (i.e. the only Period that follows the two Periods referred to in subdivision (ii)). This means that this condition is met for *disclosed segment A*.

As the two pre-conditions in subparagraph (a) and the conditions in subparagraph (b)(i) through (iv) of the transitional segment rule are met with respect to *disclosed segment A* for Period 2025, Group A will not be a Covered Group but instead *disclosed segment A* will be a *covered segment* and one or more *segment entities* of Group A will be subject to the Convention. Although *disclosed segment B* will not be a *covered segment* under the transitional rule, Group A will be fully out-of-scope.

Period 2026

Group A meets the revenue test in Article 3(1)(a) but it does not meet the profitability test in Article 3(1)(b) for Period 2026. This means that Group A will not be a Covered Group for 2026. The transitional

segment rule does not need to be considered for this Period because the first of the pre-conditions in paragraph 2(a) is not met (Group A fails the profitability test and cannot be a Covered Group under Article 3(1)). Instead based on the consolidated financial statements for 2026, *disclosed segment A* is a *covered segment* under paragraph 1 because it meets the segment revenue test and segment profitability test (noting that only the segment period test in Article 3(1)(b) is to be considered as Article 3(2) does not apply because *disclosed segment A* was a *covered segment* for Period 2025).

Period 2027

Group A meets the revenue and profitability tests in Article 3(1) and (2) for Period 2027 and reports the same *disclosed segment A* and *disclosed segment B* in its Consolidated Financial Statements. As Group A meets the two pre-conditions in subparagraph (a) of the transitional segment rule, it is again necessary to consider the four conditions in subparagraph (b)(i) through (iv).

- Subdivision (i): Based on Group A's Consolidated Financial Statements, *disclosed segment A* meets both the segment revenue test and the segment profitability test.
- Subdivision (ii): This condition remains met for *disclosed segment A* because it is met with respect to 2025.
- Subdivision (iii): This condition is met because Period 2027 falls within 2025 – 2029.
- Subdivision (iv): Based on Group A's Consolidated Financial Statements, the Amount A Profit of *disclosed segment A* calculated under Article 2(d) for 2025, 2026 and 2027 is higher than the amount of the Group that would be calculated under Article 2(d) for 2025, 2026, and 2027, as subdivision (iv) requires to test this condition for each Period that follows the two Periods referred to in subdivision(ii). This means that this condition is met for *disclosed segment A*.

As a result, Group A will not be a Covered Group, but instead *disclosed segment A* will be a *covered segment*.

Period 2028

Group A meets the revenue and profitability tests in Article 3(1) and (2) for Period 2028 and reports the same *disclosed segment A* and *disclosed segment B* in its Consolidated Financial Statements. As Group A meets the two pre-conditions in subparagraph (a) of the transitional segment rule, it is necessary to consider the four conditions in subparagraph (b)(i) through (iv).

- Subdivision (i): Based on Group A's Consolidated Financial Statements, *disclosed segment A* and *disclosed segment B* meet both the segment revenue test and the segment profitability test and hence this condition is met with respect to both *disclosed segments*.
- Subdivision (ii): This condition is met for *disclosed segment A* in 2025 but was not met for *disclosed segment B* for 2025.
- Subdivision (iii): This condition is met because the Period 2028 falls within 2025 – 2029.

- Subdivision (iv): Based on Group A's Consolidated Financial Statements, the Amount A Profit of *disclosed segment A* calculated under Article 2(d) for 2028 is not higher than the amount of the Group that would be calculated under Article 2(d) for 2028.

As a result, the exception in the transitional segment rule does not apply, and Group A will be a Covered Group under Article 3 for 2028.

Period 2029

The transitional segment rule does not need to be considered for this Period because the pre-condition in subparagraph (a) is not met (Group A was a Covered Group in a prior Period).

Example 2

The same facts as above apply with respect to Periods 2025-2027.

Period 2028

The same facts as above apply with respect to Period 2028, with one modification:

- Subdivision (iv): Based on Group A's Consolidated Financial Statements, the Amount A Profit calculated under Article 2(d) in respect of *disclosed segment A* for 2025-2028 is higher than the amount that would be calculated under Article 2(d) for 2025-2028 in respect of the Group.

As a result, Group A will not be a Covered Group, but instead *disclosed segment A* will be a *covered segment* for 2028.

Period 2029

Group A meets the revenue and profitability tests in Article 3(1) and (2) for Period 2029 and reports the same *disclosed segment A* and *disclosed segment B* in its Consolidated Financial Statements. As Group A meets the two pre-conditions of the transitional segment rule, it is again necessary to consider the four conditions in subparagraph (b)(i) through (iv).

- Subdivision (i): Based on Group A's Consolidated Financial Statements, *disclosed segment A* meets both the segment revenue test and the segment profitability test.
- Subdivision (ii): This condition remains met for *disclosed segment A* because it is met in 2025.
- Subdivision (iii): This condition is met because Period 2029 falls within 2025 – 2029.
- Subdivision (iv): Based on Group A's Consolidated Financial Statements, the Amount A Profit calculated under Article 2(d) for 2025-2029 in respect of *disclosed segment A* is higher than the amount that would be calculated under Article 2(d) for 2025-2029 in respect of the Group.

As a result, Group A will not be a Covered Group, but instead *disclosed segment A* will be a *covered segment*.

Period 2030

The transitional segment rule does not apply for this Period because the five-year period determined under subparagraph (b)(iii) has expired.

Paragraph 3

2034. Paragraph 3 replaces the terms used in the Convention for purposes of applying the Convention to a *disclosed segment* and a *covered segment* of a Group (subject to the exceptions in subparagraph (a)). The replacement terms are defined in paragraph 9.

2035. Using the replacement terms Article 3(1) and (2) read as follows:

- Article 3(1):

For purposes of this Convention, and subject to paragraph 2, a disclosed segment is a covered segment for a Period if that disclosed segment has in that Period:

- a) *segment adjusted revenues greater than EUR 20 billion; and*
- b) *a segment pre-tax profit margin greater than 10 per cent.*

- Article 3(2):

If in both of the two Periods immediately preceding a Period (or, if a Group was in existence for only one Period preceding a Period, in that one Period) a disclosed segment was not a covered segment, the disclosed segment is not a covered segment in the Period unless, in addition to the requirements of paragraph 1:

- a) *such disclosed segment has a segment pre-tax profit margin greater than 10 per cent in at least two of the four Periods immediately preceding the Period; and*
- b) *the sum of the segment adjusted profit before tax of the disclosed segment over the five-Period term ending with the Period (calculated as though the disclosed segment were a covered segment and without taking into account segment relevant net losses) divided by the sum of the segment adjusted revenues of the disclosed segment over the same term is greater than 10 per cent.*

If a Group was in existence for fewer than four Periods immediately preceding the Period, subparagraph (a) shall not apply, and subparagraph (b) shall apply with respect to the term that begins with the first Period for which the Group was in existence and ends with the Period.

Paragraph 4

2036. Paragraph 4 modifies the application of the tests in Article 3(2), as modified by Section 4, if a *segment change* occurred in the Period or any of the five Periods immediately preceding the Period. Paragraph 4(a) provides that those tests only apply if *segment restated accounts* of the *disclosed segment* are prepared for each Period that precedes the Period in which the *segment change* occurred and that falls within the four Periods that precede the Period, as those tests rely on such a restatement taking place in order to conform with the new composition of a *disclosed segment*, thus ensuring a consistent application

of these tests using equivalent financial information. This also means that paragraph 4(a) does not require a Group to prepare *segment restated accounts* where a *segment change* occurred in the fourth Period preceding the Period, as there are no additional Periods preceding the fourth Period preceding the Period that are relevant for Article 3(2), subject to subparagraphs (b) and (c).

2037. The precondition in the chapeau of Article 3(2), as modified by Section 4, that determines whether the segment prior period test and segment average test apply, requires that the *disclosed segment* would not have been a *covered segment* in both of the two prior Periods. This therefore requires an assessment of whether the *disclosed segment* would have met the segment revenue test and the segment profitability test for those two prior Periods.

2038. The assessment of whether a *disclosed segment* would or would not have been a *covered segment* in the two consecutive Periods immediately preceding the Period may in turn depend on whether the *disclosed segment* would have been a *covered segment* in the two Periods preceding those two consecutive Periods. This is because when assessing whether the *disclosed segment* would or would not have been a *covered segment* in the two consecutive Periods immediately preceding the Period, it is necessary to assess whether the segment prior period and segment average tests (based on *segment restated accounts*) will apply to those Periods which requires an additional look-back to the two Periods prior to the two consecutive Periods immediately preceding the Period. Where that additional look-back demonstrates that the *disclosed segment* would not have met the scope test in those two Periods, then the segment prior period and segment average tests will apply to the two consecutive Periods immediately preceding the Period. This means that *segment restated accounts* may have to be prepared for up to five or six prior Periods (i.e. for the two consecutive Periods immediately preceding the Period and the four Periods preceding them in order to apply the segment prior period and segment average tests). Therefore, paragraph 4(b) provides that *segment restated accounts* will have to be prepared for the fifth Period that precedes the Period, but only where the *disclosed segment* meets the requirements of Article 3(1) for the first Period that precedes the Period (which should be assessed by reference to the *segment restated accounts*, as applicable) because it would already be clear that the *disclosed segment* is out of scope if it fails the tests in Article 3(1). Equally, paragraph 4(c) provides that *segment restated accounts* will have to be prepared for the fifth and the sixth Period that precedes the Period, but only where the *disclosed segment* meets the requirements of Article 3(1) for the second Period that precedes the Period. This approach limits the administrative burden by only requiring the preparation of *segment restated accounts* for more than four prior Periods where necessary.

2039. If *segment restated accounts* are not prepared for all of the relevant Periods that precede the *segment change*, the tests in Article 3(2) do not apply.

2040. In case the tailing clause in Article 3(2) applies (noting this clause is not modified by paragraph 3), *segment restated accounts* have to be prepared for each Period that precede the Period in which the *segment change* occurred and for which a Group was in existence in order for Article 3(2)(b) to apply (noting that the prior period test in Article 3(2)(a) is switched off by the tailing clause for any *disclosed segment*).

2041. The reason for this approach is to ensure that the segment prior period test and segment average test only apply insofar as the composition of a *disclosed segment* is consistent over the relevant Periods. The reporting of *disclosed segments* in a Group's Consolidated Financial Statements are often relatively stable across Periods, but a Group may change how it reports its *disclosed segments* for different reasons. For instance, a *segment change* may occur solely due to how a Group reports its *disclosed segment* in the Consolidated Financial Statements, absent a physical change in structure, reorganisation or change in composition of the Group, and this could constitute a change to the composition of the *disclosed segments*. In other instances, a *segment change* could occur following underlying changes in the management

structure, the growth of a business unit or region, or a decision to highlight particular financial information to certain stakeholders and external investors which may lead, for example, to a change in the mix of products or services reported for each of the segments. Such changes include, for example, reporting a particular division, or part of a division, in a different *disclosed segment*, whether new or existing, or, alternatively, combining two previously separate *disclosed segments* into a single *disclosed segment*. The determining factor here is whether the Group is required to disclose whether it has restated the corresponding items of segment information for prior Periods following a change to how the *disclosed segments* are reported. The concept of *segment change*, which broadly follows accounting rules, is used to distinguish between situations where the composition of *disclosed segments* has remained constant and where it has not (see paragraph 2051 of this Explanatory Statement for further details). Absent this approach, there is a risk the prior period and average tests would apply inappropriately taking into account segment financial data of prior Periods that have no or little connection to the actual composition of a *disclosed segment* in later Periods.

2042. To avoid such an outcome, paragraph 4 provides that the prior period and average tests only apply where the composition of a *disclosed segment* remains consistent over the Period and the five Periods immediately preceding the Period or, in case a *segment change* involving the *disclosed segment* has occurred, where *segment restated accounts* have been prepared for the relevant Periods referred to in subparagraphs (a) through (c). An illustration of the application of paragraph 4 where *segment restated accounts* of the *disclosed segment* have been prepared can be found below.

Box 31. Example – Application of paragraph 4

A multinational enterprise, Group A, meets the revenue but not the profitability tests in Article 3(1) for Period 2025 and reports two *disclosed segments* in its consolidated financial statements (*disclosed segment A* and *disclosed segment B*). Also in 2025, a *segment change* involving both *disclosed segments* occurred and the Group prepared *segment restated accounts* covering both *disclosed segments* for the four Periods immediately preceding 2025 (i.e. 2024, 2023, 2022 and 2021).

Only *disclosed segment A* meets the segment revenue test in paragraph 1 for 2025 and thus it is necessary to assess whether *disclosed segment A* also meets the segment profitability test in paragraphs 1 and, where applicable, 2 for 2025.

Paragraph 4 applies because a *segment change* occurred in the Period.

Assuming *disclosed segment A* meets the segment period test for 2025, the next step is to assess whether the segment prior period test and segment average tests apply by evaluating whether *disclosed segment A* would have been a *covered segment* in the two consecutive Periods immediately preceding the Period based on the *segment restated accounts*. If *disclosed segment A* would have been a *covered segment* in either of Period 2024 or 2023, then the segment prior period and segment average tests will be “switched off” for 2025 and *disclosed segment A* will be a *covered segment*.

To assess this, the Group will have to apply the segment revenue and segment profitability tests to *disclosed segment A* for 2024 and 2023 based on the *segment restated accounts*. Assuming the segment revenue test and the segment profitability test for the Period are met for both prior Periods 2024 and 2023, next it is again necessary to assess whether the segment prior period and segment average tests apply, this time for 2023 and 2024. To do this it must be established whether *disclosed segment A* was a *covered segment* in either of 2022 or 2021 using the rules in paragraph 1 and based on the *segment restated accounts* prepared for 2022 and 2021 under paragraph 4(a). Assuming

disclosed segment A meets the tests in paragraph 1 for 2022, *segment restated accounts* will have to be prepared for 2020 (i.e. the fifth period preceding the Period) under paragraph 4(b). The same process applies for 2021, which means that in this example *segment restated accounts* may have to be prepared for a total of six prior Periods (back to 2019 under paragraph 4(c)) to determine whether the segment prior period and segment average tests apply for Period 2025.

Article 3(2) will apply if Group A prepares *segment restated accounts* for the relevant prior Periods, as prescribed in paragraph 4.

It is not necessary to prepare *segment restated accounts* for more than six prior Periods as the availability of *segment restated accounts* for the four prior Periods preceding Periods 2023 and 2024 provide sufficient information to assess whether the *disclosed segment A* would have been a *covered segment* in either of Period 2024 or 2023, which in turn informs whether the segment prior period and segment average tests apply for Period 2025.

Paragraphs 5 and 6

2043. Paragraphs 5 and 6 provide additional scoping criteria that supplement the conditions in paragraph 1 in case a *disclosed segment* is reported by either a Group that includes a *regulated financial institution* or a *qualifying extractives group*. Those paragraphs clarify what is provided in Article 3, namely that such a *disclosed segment* that would otherwise be a *covered segment* under paragraph 1 is not a *covered segment* unless it satisfies the modified scoping criteria in Section 2 or 3, respectively, as well as Section 4.

Paragraph 7

2044. Paragraph 7 supplements the rules on Elimination Profit (or Loss) and the rules on the Return on Depreciation and Payroll for purposes of a specific situation involving a Group Entity that meets the definition of *segment entity* in respect of two or more *disclosed segments*, because its income and expenses are reported in two or more *disclosed segments* of the same Group. Such a Group Entity will meet the definition of *mixed segment entity*.

2045. Where a *covered segment* reports a *mixed segment entity*, adjustments are required to ensure that only the relevant financial information of the *mixed segment entity* is taken into account as it relates to the *covered segment* for purposes of elimination of double taxation, and not to the operations of the Group reported in a different *disclosed segment*. This approach aligns with the general concept followed throughout the Convention, as it relates to a *covered segment*, which is to treat a *covered segment* as a separate and independent business for purposes of applying the Convention. If such adjustments were not made, then the *entity elimination profit (or loss)* and *accounting depreciation* and *accounting payroll* of a *mixed entity* that relates to a different *disclosed segment* would be taken into account for purposes of elimination of double taxation for the *covered segment*, with the possible consequence that a Party may be obliged to provide relief under the Convention in respect of profits that do not relate to the operations of that *covered segment* carried on in that Party.

2046. In order to accurately determine the Elimination Profit (or Loss) and the *jurisdictional depreciation and payroll* of a *covered segment* that reports a *mixed segment entity*, the following adjustments are required:

- First, with respect to the *covered segment's* Elimination Profit (or Loss) in the Jurisdiction, the *entity elimination profit (or loss)* of the *mixed segment entity* and the *taxable presence elimination profit (or loss)* of each *taxable presence* of the *mixed segment entity* should be adjusted to ensure that only the *entity elimination profit (or loss)* and *taxable presence elimination profit (or loss)* that relate to the business of the *covered segment* are taken into account. This is achieved by providing that *entity elimination profit (or loss)* and *taxable presence elimination profit (or loss)* are only taken into account for purposes of determining the *covered segment's* Elimination Profit (or Loss) in the Jurisdiction to the extent that the income and expense items giving rise to the Elimination Profit (or Loss) in the Jurisdiction are taken into account in the calculation of the *segment financial accounting profit (or loss)* of the *covered segment*.
- Second, with respect to the *covered segment's jurisdictional depreciation and payroll*, the *accounting depreciation* and *accounting payroll* of the *mixed segment entity* should also be adjusted to ensure that only the *accounting depreciation* and *accounting payroll* that relate to the business of the *covered segment* are taken into account. This is achieved by providing that *accounting depreciation* is reflected to the extent that the *eligible assets* give rise to expenses that are taken into account in the calculation of the *segment financial accounting profit (or loss)*; and, by providing that *accounting payroll* is reflected to the extent that the relevant payroll costs are taken into account in the calculation of the *segment financial accounting profit (or loss)*.

2047. For completeness, those adjustments are not required where a Group Entity meets the definition of *segment entity* in respect of only one *covered segment* because, in such a case, the rules in Annex B Section 4, as modified by paragraph 3, lead to the correct outcome of the *segment entity's entity elimination profit (or loss)*, *accounting depreciation* and *accounting payroll* that relate only to the *covered segment*: the *covered segment's* Elimination Profit (or Loss) in the Jurisdiction and *jurisdictional depreciation and payroll* of the *covered segment* will be recognised in the Jurisdictions where the *segment entities* are located (subject to certain adjustments, such as for *taxable presences*) whether the *covered segment* is reported on a business line, geographical basis or any other basis.

Paragraph 8

Disclosed segment

2048. Subparagraph (k) provides the definition of a *disclosed segment* which means any segment reported in a Group's Consolidated Financial Statements prepared under an Acceptable Financial Accounting Standard. The definition of a *disclosed segment* for purposes of the Convention follows disclosure requirements under the relevant Acceptable Financial Accounting Standard and where no segmental reporting is disclosed in the Consolidated Financial Statements of the Group, there is no requirement to prepare bespoke segments for purposes of the Convention. Any adjustments that are required under the Convention will only apply in respect of a segment reported in the Consolidated Financial Statements of the Group which meets the definition of *disclosed segment*.

2049. The definition of *disclosed segment* includes a segment reported in the Consolidated Financial Statements of a Group on the basis of a product or service line, geographical area, customer base, regulatory environment or another basis, or a combination thereof. The determination of how a Group reports its segments will follow the commercial and operational organisation of the business and should allow the reader to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. The precise nature of segmental reporting will likely vary between different Groups as disclosure requirements will typically depend on how information is reported to decision makers or decision-making functions within the business which are responsible for

allocating resources and assessing the performance of the segments. For instance: see IFRS 8 Operating Segments; see US GAAP ASC 280.

2050. Under an Acceptable Financial Accounting Standard, a *disclosed segment* will be clearly identified and reported as segmental information in a dedicated section or note part of the Consolidated Financial Statements of a Group, and Acceptable Financial Accounting Standards do not permit the reporting of segmental information on numerous bases. The Group may report additional breakdowns or subdivisions of financial information of the Group in its Consolidated Financial Statements for commercial, regulatory, or other purposes, but this information will not be reported as segment information for Acceptable Financial Accounting Standard purposes, so the definition of *disclosed segment* will not be satisfied for purposes of the Convention in that case. Similarly, a Group may not be required to report on a segment basis under an Acceptable Financial Accounting Standard but may still provide additional breakdowns or subdivisions of financial information of the Group in its Consolidated Financial Statements. Again, this latter category of reporting will not meet the definition of *disclosed segment* for purposes of the Convention.

Segment change

2051. Subparagraph (l) provides the definition of *segment change* for the purpose of applying paragraph 4 and the profitability test in Article 3(2) and the definition of *segment relevant net losses*. The definition is formulated broadly and leverages on the language used in paragraph 29 of IFRS 8: Operating Segments.

2052. The definition treats any change to the composition of a Group's *disclosed segments* from the prior Period as a *segment change* provided that the change triggers a requirement under an Acceptable Financial Accounting Standard for the Group to disclose whether it has restated the corresponding items of segment information for prior Periods (see paragraph 2051 of this Explanatory Statement for further details).

2053. An Acceptable Financial Accounting Standard generally requires a Group to disclose in its Consolidated Financial Statements whether a change to the composition of its *disclosed segments* occurred and whether it has restated information for prior Periods. It should therefore be relatively straightforward for tax authorities to assess whether a *segment change* occurred in a Period.

Segment entity and mixed segment entity

2054. Subparagraph (m) provides the definition of *segment entity* and builds on the definition of Group Entity in Article 2. This means that where an Entity does not meet the definition of Group Entity, that Entity cannot meet the definition of *segment entity*.

2055. The definition of *segment entity* is structured in two parts:

- First, it includes any Group Entity whose income and expenses, in whole or part, are included in a *disclosed segment*. This part of the definition requires an examination of whether a Group Entity's results are included in the calculation of the *segment financial accounting profit (or loss)* of a *disclosed segment* in the Consolidated Financial Statements of the Group under an Acceptable Financial Accounting Standard.
- Second, it includes any Group Entity whose income and expenses, in whole or part, are included in the calculation of *segment adjusted profit before tax* of a *disclosed segment*. Therefore, this part of the definition broadens the criteria for a Group Entity to meet the definition of *segment entity* beyond Group Entities whose financial results are included in a *disclosed segment* in a Group's Consolidated Financial Statements. It includes Group Entities that have income or costs that meet the definitions of *unallocated income*, *unallocated expense* and *corporate segment income* or

expense, provided that they are allocated to the *disclosed segment* in the calculation of its *segment adjusted profit before tax*.

2056. Where a Group Entity does not meet either part of the definition explained above it will not be a *segment entity*. Such a Group Entity will not be subject to the obligations contained in the Convention under Article 3(6).

2057. Where a Group Entity meets the definition of *segment entity* in respect of two or more *disclosed segments* then that Group Entity will be a *segment entity* in respect of each *disclosed segment* and will be a *mixed segment entity*, as defined in subparagraph (n). In such case the *segment entity* will be subject to the obligations contained in Section 4 in respect of each *disclosed segment*.

Segment restated accounts

2058. Subparagraph (o) provides the definition of *segment restated accounts* which is used for purposes of paragraph 4 and for applying the profitability test in Article 3(2), where relevant, as modified by Section 4 (as well as other Sections). Importantly, the definition of *segment restated accounts* requires that a full, as opposed to a partial, restatement of the relevant financial information occurred in either the Consolidated Financial Statements or in an independently audited schedule. Where only a partial restatement occurs, such a restatement will not meet the definition of *segment restated accounts*.

Allocation factor and alternative allocation factor

2059. Subparagraph (r) provides the definition of *allocation factor*, which is used for purposes of calculating the *segment adjusted profit before tax* and, more specifically, for allocating *unallocated income, unallocated expense and corporate segment income or expense* to a *disclosed segment* under subparagraph (d)(i). Such allocation ensures all relevant income and costs are taken into account when computing the *segment adjusted profit before tax* and that the tax base for a *covered segment* is calculated in a consistent manner and is aligned with the calculation of the tax base of a Covered Group.

2060. In order to simplify the allocation exercise, a single *allocation key* is used. This *allocation key* looks to the revenues of each *disclosed segment* and compares this absolute amount with the sum of the revenues of all the *disclosed segments* of a Group. Any items of *unallocated income, unallocated expense or corporate segment income or expense* are then allocated to a *disclosed segment* in proportion to its share of revenues as compared to the sum of all revenues. The use of revenues to determine the *allocation factor* is likely to be reasonable and appropriate in most cases because revenues are a good indicator of the relative size of a *disclosed segment's* business relative to the Group and also noting that items of *unallocated income, unallocated expense and corporate segment income or expense* are typically relatively small in quantum.

2061. However, where using the *allocation factor* leads to inappropriate outcomes that are material, a Group can elect to use an *alternative allocation factor*, defined in subparagraph (s), for a particular item of *unallocated income, item of unallocated expense or item of corporate segment income or expense* provided certain conditions are met. Subparagraph (e) provides the conditions where a Group may optionally elect to use an *alternative allocation factor*. In practice, such instances are expected to be relatively rare given the items of *unallocated income, unallocated expense or corporate segment income or expense* are most commonly observed where use of the *allocation factor* (i.e. revenues) will likely be appropriate.

2062. A Group may only use an *alternative allocation factor* where three conditions are met.

- First, the Group elects to use an *alternative allocation factor* for relevant items of income or expenses as provided for in subparagraph (s).
- Second, the *alternative allocation factor* must be used consistently for the applicable item of *unallocated income, unallocated expense or corporate segment income or expense* by all *disclosed segments* for the Period. This condition ensures that all items of *unallocated income, unallocated expense or corporate segment income or expense* are fully allocated between the *disclosed segments*.
- Third, a materiality threshold is provided in order to limit the instances where an *alternative allocation factor* can be utilised to cases where there will be a material impact on the calculation of the *segment adjusted profit before tax*. The materiality threshold is applied by calculating the *segment adjusted profit before tax* calculation using both the *allocation factor* and the *alternative allocation factor* which is considered more appropriate for adjusting for a particular item of *unallocated income, unallocated expense or corporate segment income or expense*. The result of applying the *alternative allocation factor* is then tested and only when the impact on the *disclosed segment's segment adjusted profit before tax* using the *allocation factor*, is greater than 10 per cent, is the materiality threshold satisfied.

2063. An *alternative allocation factor* is an *allocation key* on an exhaustive list of factors which a Group can choose to apply in respect of an item listed in subparagraph (s)(i) through (vii). This approach allows a Group to consider an *alternative allocation factor* that uses a different *allocation key* (e.g. based on staff headcount, asset book value, floor space) given the nature of the particular item of *unallocated income, unallocated expense or corporate segment income or expense*. The application of one of those factors may lead to an allocation to one or more *disclosed segments*, even though the particular item of *unallocated income, unallocated expense or corporate segment income or expense* was not subject to a direct allocation for segment reporting purposes in the Consolidated Financial Statements. The *allocation key* of the *alternative allocation factor* is determined by dividing the amount of a factor for a *disclosed segment* (for example, 100 staff headcount for *disclosed segment A* in case of determining the *allocation key* for pension costs) with the amount using the same factor for all *disclosed segments* (for example, 500 staff headcount across all *disclosed segments*, meaning the *alternative allocation factor* for allocating unallocated pension costs to *disclosed segment A* would be 20 per cent).

Corporate segment and corporate segment income or expense

2064. Subparagraphs (t) and (u) provide the definitions of *corporate segment* and *corporate segment income or expense*, respectively. Those definitions support the calculation of *segment adjusted profit before tax*, which requires the allocation of *corporate segment income or expense* (as well as items of *unallocated income and unallocated expense*). The definition of *corporate segment* and *corporate segment income or expense* ensures that items of income or expense of a *disclosed segment* that reports centralised costs, not incurred on its own account, are allocated appropriately between the other *disclosed segments* that the Group reports. This means that all relevant items of income or expense of the Group reported in the Consolidated Financial Statements are taken into account when calculating the *segment adjusted profit before tax*, as a reliable measure of each *disclosed segment* net profit. The two definitions achieve this by, firstly, defining a *corporate segment income or expense* as any item of income or expense of a *corporate segment* and, secondly, defining a *corporate segment* as a *disclosed segment* where all, or substantially all, of the expenses that it reports were not incurred for the purpose of generating *segment adjusted revenues* of that *disclosed segment*.

Unallocated expense and unallocated income

2065. Subparagraphs (p) and (q) provide the definitions of *unallocated expense* and *unallocated income*, which are allocated between *disclosed segments* of the Group for purposes of the calculation of *segment adjusted profit before tax*. This is a negative definition which looks to identify any item of expense or income that are not reported in the calculation of the *segment financial accounting profit (or loss)* of a *disclosed segment* but are reported in the calculation of the Financial Accounting Profit (or Loss) of the Group. An Acceptable Financial Accounting Standard generally provides some flexibility to Groups in determining which categories of expenses and income are left unallocated and will therefore meet the definition of *unallocated expense* or *unallocated income*. Some Groups will have relatively low amounts of such items, others may have higher amounts. Common examples of such *unallocated expense* include personnel and IT, interest expense or income, other financial charges, litigation costs, or goodwill and intangibles impairments.

Segment relevant net losses

2066. Subparagraph (f) defines the term “segment relevant net losses”. This is relevant to compute the “segment adjusted profit before tax”, defined in subparagraph (d), which provides for the deduction of *segment relevant net losses*. These include: (i) the “segment eligible net losses” of the *covered segment*; and (ii) any “segment transferred losses” available pursuant to an “eligible business combination” or an “eligible division” involving the *covered segment*, if certain conditions are satisfied.

2067. The definition of “segment relevant net losses” mirrors that of “relevant net losses”, applicable in the context of the group-level loss carry-forward rules in Annex B Section 2(3), except that it refers to *segment eligible net losses* and *segment transferred losses* (defined in subparagraphs (g) and (h), respectively). It also only covers *eligible business combinations* and *eligible divisions* that involve the *covered segment* (i.e. which result in at least one entity of the *transferred entity or group* or *predecessor group* being transferred to the *covered segment*: see the attribution method described in the definition of “segment transferred losses” in subparagraph (h)).

2068. The deduction of *segment transferred losses* is subject to the conditions described in Annex B Section 2(3)(b)(i) through (iii) as applied to the Group reporting the *covered segment*. In other words, the same business continuity requirements apply, at a group level, as those applicable to a Covered Group under the general rules in Annex B Section 2(3)(b)(i) and (ii). *Segment transferred losses* arising from an *eligible business combination* or *eligible division* (defined in Annex B Section 5) are similarly deducted at the election of taxpayer, i.e. the Group reporting the *covered segment*. This election must be lodged in accordance with the general rule described in Annex B Section 2(3)(b)(iii). However, to prevent double-counting at group and segment levels, *segment transferred losses* cannot be recognised in respect of an *eligible business combination* or *eligible division* if the Group reporting the *covered segment* was previously a Covered Group that made an election to deduct *transferred losses* pursuant to Annex B Section 2(3)(b)(iii) (i.e. at group level) arising from the same transaction.

Segment eligible net losses

2069. Subparagraph (g) defines the term “segment eligible net losses”. This represents the amount of historic losses incurred by the *covered segment* that can be carried forward and deducted in the current Period, as part of the *covered segment's segment relevant net losses*, as provided in subdivision (iii) of the definition of *segment adjusted profit before tax* (defined in subparagraph (d)).

2070. The calculation of *segment eligible net losses* requires a retrospective computation starting from the *segment financial accounting profit (or loss)* of each *segment eligible prior period* and making the adjustments described in subdivisions (i) and (ii) of the definition of “segment adjusted profit before tax”,

as well as any other adjustment necessary to ensure that the *segment eligible net losses* are deducted in the chronological order of the prior Period(s) to which they correspond. *Segment eligible net losses* will exist to the extent that, after making those adjustments for each *segment eligible prior period*, the total amount of cumulative *segment financial accounting losses* exceeds the total amount of cumulative *segment financial accounting profits* over those *segment eligible prior periods*. The reference to the adjustments described in subdivisions (i) and (ii) of the definition of “segment adjusted profit before tax” means that, to achieve consistency, the same tax base rules apply to calculate the profit or loss of the current period and that of any *segment eligible prior period*.

2071. This definition mirrors that of “eligible net losses”, applicable in the context of the general group-level loss carry-forward rules in Annex B Section 2(3)(a), except that it refers to *segment financial accounting profits* and *losses* and *segment eligible prior periods* (defined in subparagraphs (c) and (i), respectively).

Segment transferred losses

2072. Subparagraph (h) defines the term “segment transferred losses”. These may be deducted, as part of the *segment relevant net losses*, pursuant to an *eligible business combination* or *eligible division* involving the *covered segment*. The rules to compute *segment transferred losses*, together with the conditions for their availability, are intended to ensure consistency between the transfer of losses at the group and segment levels.

2073. The deduction of *transferred losses* is made at the election of the Group reporting the *covered segment* and is subject to group-level business continuity requirements (as set out in subdivision (ii) of the definition of “segment relevant net losses” in subparagraph (f), with reference to the general conditions described in Annex B Section 2(3)(b)). The election is lodged in respect of the *covered segment*, for a particular *eligible business combination* or *eligible division*. If the Group reporting the *covered segment* becomes a Covered Group in a later Period, in computing its adjusted profit before tax for that Period under Annex B Section 2, the Covered Group may lodge a separate election to deduct *transferred losses* (if any) arising from the same *eligible business combination* or *eligible division* to the extent that such *transferred losses* have not been attributed to the *covered segment* under this subparagraph. For further detail, see the transitional rules in Annex B Section 2(3)(c).

2074. The starting point to determine *segment transferred losses* pursuant to an *eligible business combination* or *eligible division* is the amount calculated pursuant to Annex B Section 2(4) (i.e. at the group level), as applied to the Group reporting the *covered segment*. A portion of this amount, if any, is then attributed to the *covered segment* based on an *allocation key*.

2075. The *allocation key* is intended to reflect the relative size of the part of the transferred business that is transferred to the *covered segment*, with reference to third-party entity revenues. Specifically, the group-level *transferred losses* are attributed to the *covered segment* based on the ratio of aggregate revenues of the entities transferred to the *covered segment* as a result of the *eligible business combination* or *eligible division*, as compared to the aggregate revenues of all the entities transferred to the Group reporting the *covered segment* as a result of the same transaction. For this purpose, reference is made to the revenues reported in the consolidated financial statements of the *transferred entity or group* or *predecessor group* in the period immediately preceding the *eligible business combination* or *eligible division*.

Segment eligible prior period

2076. Subparagraph (i) defines the term “segment eligible prior period” to include each Period: (i) starting with the earliest Period, if any, that falls within specified time limitations and for which, after making the

adjustments described in subdivisions (i) and (ii) of the definition of “segment adjusted profit before tax”, there is a *segment unused loss* (irrespective of whether the segment was a *covered segment* during that earlier period), and (ii) ending with all Periods after that Period and before the current Period. However, to avoid double-counting between group and segment level profits and losses under the Convention, certain prior Periods are excluded.

2077. The definition of a “segment eligible prior period” largely mirrors that of an “eligible prior period”, applicable in the context of the group-level loss carry-forward rules in Annex B Section 2(3), except that it refers to *segment unused losses* (defined in subparagraph (j)) and contains two additional limitations. These limitations, discussed below, aim to address the interaction between group- and segment-level loss carry-forwards, and to ensure the integrity of the loss-carry forward mechanism following a *segment change*.

2078. First, a transitional rule is provided for cases where the Group reporting the *covered segment* was a Covered Group in a prior Period. It is intended to prevent the double-counting of profits and losses at the Group and segment levels. The reverse scenario (i.e. where the Group reporting the *covered segment* later comes into scope of the Convention) is addressed as part of the rules to determine *relevant net losses* of a Covered Group in Annex B Section 2(3).

2079. The transitional rule excludes from the definition of “segment eligible prior period” any prior Period in which the Group reporting the *covered segment* was a Covered Group, or which was an *eligible prior period* of that Group, with the exception of prior periods that have already been considered as *segment eligible prior periods* of the *covered segment* (such that any segment-level profits and losses for those periods would have been disregarded at Group level, eliminating any risk of double-counting). This effectively excludes from the calculation of “segment eligible net losses” all profits and losses of the *covered segment* that have already been taken into account, as part of the consolidated accounts of the Group reporting the *covered segment*, in computing that Group’s adjusted profit before tax under the Convention (either because the Group was a Covered Group in a period, or because the Group’s profits or losses from a period were taken into account in calculating the Group’s *relevant net losses* carried forward and deducted under the Convention). Any earlier non-excluded Period may nevertheless qualify as a *segment eligible prior period*, subject to the other applicable criteria. This way, unrelieved segment losses incurred at an earlier time (subject to the other applicable criteria) and not already taken into account under the Convention at the Group-level, would remain available for carry-forward and deduction by the *covered segment*. This rule works together with the condition described in division (ii) of the definition of “segment relevant net losses”, addressing double-counting in respect of *transferred losses*. That rule ensures that the segment cannot deduct *transferred losses* arising from an *eligible business combination* or *eligible division* in cases where the Group reporting the *covered segment* was previously a Covered Group and made an election to deduct group-level *transferred losses* arising from the same transaction.

Box 32. Example – Interaction between disclosed segment- and group- level losses (Group reporting the covered segment was previously a Covered Group)

This example makes reference to the Financial Accounting Profit of Group X (after making the relevant adjustments under Annex B Section 2(1)(a) to (d)) and the segment Financial Accounting Profit of *disclosed segment* C (after making the relevant adjustments in divisions (i) and (ii) of the definition of “segment adjusted profit before tax”). These figures are reflected in the table further below.

The facts of this example are as follows. Group X becomes a Covered Group for the first time in P-2 as it satisfies the conditions in Article 3(1) and (2) in P-2. Group X has not incurred any historic losses, at a consolidated level, except in P-3. None of its *disclosed segments* has ever been a *covered segment*, and no *segment changes* have ever taken place.

- The Financial Accounting Profit of Group X in P-2, after making the relevant adjustments under Annex B Section 2(1)(a) through (d), is EUR 2.1 billion.
- In computing its adjusted profit before tax for P-2, Group X carries forward and deducts *relevant net losses* of EUR 150 million (such that its adjusted profit before tax for P-2 is equal to EUR 1.95 billion). These *relevant net losses* are entirely constituted by *eligible net losses* arising in P-3, which is the sole *eligible prior period* of Group X. Group X does not elect to recognise any *transferred losses*.

In the following period (P-1), Group X is no longer a Covered Group.

In P, one of the *disclosed segments* reported by Group X (*disclosed segment C*) becomes a *covered segment* for the first time as it satisfies the conditions in Article 3(1) and (2), as modified by Section 4, in P. The only historic losses incurred in *disclosed segment C* relate to P-3 and P-4.

The segment financial accounting profit of *disclosed segment C* in P, after making the relevant adjustments in subdivisions (i) and (ii) of the definition of “segment adjusted profit before tax”, is EUR 2.05 billion. To compute the *segment adjusted profit before tax*, any *segment relevant net losses* (comprising both *segment eligible net losses* and *segment transferred losses*, if any) must be deducted from that amount.

- *Segment eligible net losses* of *disclosed segment C* are determined by reference to its *segment eligible prior periods*, if any. To avoid double counting, any period in which Group X was a Covered Group (P-2), or that was an *eligible prior period* of Group X (P-3) is excluded from the definition of *segment eligible prior period*:
 - P-4 is the earliest prior period within applicable time limitations and with a *segment unused loss* (clause (i) of the definition of *segment eligible prior period*). P-2 and P-3 are excluded from the definition of *eligible prior period*, such that P-1 is the only subsequent period between P-4 and the current period that is taken into account. P-4 and P-1 are therefore the *segment eligible prior periods* of Segment C.
 - The *segment eligible net losses* of *disclosed segment C* are equal to EUR 50 million (EUR 150 million [P-4] – EUR 100 million [P-1]), i.e. the total amount of cumulative segment financial accounting losses that exceed the total amount of cumulative segment financial accounting profits over the *segment eligible prior periods* P-4 and P-1 (after making relevant adjustments in each period).
- No election is made to recognise *segment transferred losses*.
- In computing its *segment adjusted profit before tax* for P, *disclosed segment C* carries forward and deducts *segment relevant net losses* of EUR 50 million (such that its *segment adjusted profit before tax* for P is equal to EUR 1.9 billion). These *segment relevant net losses* are constituted by the aforementioned *segment eligible net losses*, which have been computed without regard to the profits and losses from P-3 and P-2 (because such profits and losses have

already been taken into account, for purposes of the Convention, in computing the adjusted profit before tax of Group X in P-2).

Adjusted group or segment financial accounting profit (or loss), in EUR million

	<i>Prior periods</i>	P-4	P-3	P-2	P-1	P
Group X		2100	-150	2100	1,650	1950
Disclosed segment A	<i>no losses at Group or segment levels</i>	1050	100	550	1,200	100
Disclosed segment B		1200	-150	600	350	-200
Disclosed segment C		-150	-100	950	100	2050

2080. Second, subparagraph (i)(B) of the definition contains a rule to ensure the integrity of the loss carry-forward mechanism following a *segment change*, providing for a level of consistency in the composition of the *covered segment* over time for the purpose of carrying forward losses (see definition of “segment change” in subparagraph (l)). Unless certain conditions are met, only periods ending after the latest *segment change* involving the *covered segment* can qualify as a *segment eligible prior period* (subparagraph (i)(B)(1) of the definition). In other words, the *covered segment* generally cannot carry-forward losses incurred before the latest *segment change* that it was involved in.

2081. However, by exception to this rule, subparagraph (i)(B)(2) allows periods prior to the latest *segment change* to qualify as *segment eligible prior periods* (such that losses incurred in those periods can be carried forward and deducted) to the extent that:

- *Segment restated accounts* of the *covered segment* have been prepared for those periods. This way, *segment relevant net losses* are computed by reference only to historic financial information that accurately reflects the composition of the *covered segment* in the current period; and
- No *disclosed segment* involved in that *segment change* was itself a *covered segment* that previously deducted *segment relevant net losses*. This prevents the risk that the same losses could be deducted more than once under the Convention.

Segment unused loss

2082. Subparagraph (j) defines the term “segment unused loss” as a segment financial accounting loss of a period that has not been offset by segment financial accounting profit of a subsequent period, after making the adjustments described in subparagraph (j)(i) and (ii) of the definition of “segment adjusted profit before tax” in each period, in accordance with the rules of subparagraph (j)(iii) of that definition. A “segment unused loss” is therefore an amount that may give rise to a “segment relevant net loss”, deductible in the current period.

2083. This definition mirrors that of an “unused loss”, applicable in the context of the group-level loss carry-forward rules in Annex B Section 2(3), except that it refers to *segment financial accounting profit (or loss)* (defined in subparagraph (c)).

Section 5 – Autonomous domestic business exemption

Paragraph 1

2084. Paragraph 1 provides that the adjustments in paragraphs 3 through 5 and in paragraphs 11 and 12 shall be made in a Period where a Covered Group operates in a Jurisdiction that is an *autonomous domestic business jurisdiction*, as defined in paragraph 2(a) and subject to the stabilisation mechanism in paragraph 10. Those adjustments effectively exclude the financial results of a Covered Group that are derived from an *autonomous domestic business jurisdiction* for purposes of profit allocation under Article 5 and elimination of double taxation under Articles 9 through 13. This means that a Jurisdiction will not be allocated Amount A in respect of a domestically and autonomously orientated business of a Covered Group carried on in a Jurisdiction nor be obliged to provide relief for elimination of double taxation purposes in respect of the profits earned from those operations. The determination of whether a Jurisdiction is an *autonomous domestic business jurisdiction* depends on whether a Covered Group's operations in the Jurisdiction meet this definition. This means that a Jurisdiction can be an *autonomous domestic business jurisdiction* in respect of a Covered Group, but not in respect of other Covered Groups.

2085. Paragraph 3 provides the adjustments to the Elimination Profit (or Loss) and the *jurisdictional depreciation and payroll* of a Covered Group where a Jurisdiction is an *autonomous domestic business jurisdiction*. The adjustments in paragraphs 3 apply on a jurisdictional basis, whereas, the adjustments in paragraph 4 apply to the consolidated financial results of the Group where a Jurisdiction is an *autonomous domestic business jurisdiction* to calculate the *non-domestic autonomous adjusted profit before tax* and *non-domestic autonomous adjusted revenues* of the Covered Group. Paragraph 5 provides for the replacement of the terms *accounting depreciation* and *accounting payroll* for purposes of the term "Elimination Threshold Return on Depreciation and Payroll" in Article 2(n) with the terms *non-domestic autonomous accounting depreciation* and *non-domestic autonomous accounting payroll*, respectively. Paragraphs 11 and 12 provide for potential adjustments in prescribed circumstances with respect to elimination of double taxation and the allocation of Amount A Profit.

Paragraph 2

2086. Paragraph 2 provides the definition of an *autonomous domestic business jurisdiction*, as well as the related operative definitions. This definition functions as the "entry test" to determine whether the adjustments in paragraphs 3 through 5 and paragraphs 11 through 12 should be made in respect of a Covered Group for a Period.

2087. Where a Jurisdiction is an *autonomous domestic business jurisdiction* under subparagraph (a), adjustments are made under paragraphs 3 through 5 to exclude the financial results of the Covered Group's operations that are substantially all domestically and autonomously focused in the Jurisdiction for purposes of elimination of double taxation and Amount A Profit allocation. Potential adjustments with respect to elimination of double taxation and the allocation of Amount A Profit are made under paragraphs 11 and 12.

2088. The entry test in subparagraph (a) includes three conditions in subdivisions (i) through (iii), all of which need to be met for a Jurisdiction to be an *autonomous domestic business jurisdiction*.

2089. The first condition in subdivision (i) assesses the level of deviation between the Adjusted Revenues treated as arising in that Jurisdiction under Article 6 and the sum of Entity Financial Third-party Accounting Revenues of Group Entities located in that Jurisdiction (i.e. third-party revenues booked in the Jurisdiction,

after making certain adjustments). This condition measures the level of integration on the income-side of the business of the Covered Group in the Jurisdiction with other Jurisdictions that the Covered Group operates in (i.e. sales to third-parties in another Jurisdiction). In a case where third-party sourced revenues and booked revenues closely align, the business of the Covered Group in the Jurisdiction is selling to third parties in that Jurisdiction, as opposed to selling to third parties located in another Jurisdiction. Put differently, it seeks to ensure that the third-party revenues booked in the Jurisdiction are substantially all also sourced to the Jurisdiction. The condition is satisfied when the Adjusted Revenues of the Covered Group that are treated as arising in the Jurisdiction do not fall below 95 per cent of the sum of the Entity Financial Third-party Accounting Revenues of the Group Entities located in the Jurisdiction and do not exceed 105 per cent of the sum of the Entity Financial Third-party Accounting Revenues.

2090. The second condition in subdivision (ii) assesses the level of *cross-border intra-group revenues* of Group Entities located in the Jurisdiction relative to the total revenues of those Group Entities. This condition measures the level of integration on the income-side of the business with Group Entities located in other Jurisdictions. In a case where *cross-border intra-group revenues* of Group Entities located in the Jurisdiction are at a low-level and do not exceed 15 per cent of the sum of the total revenues included in calculating the Entity Financial Accounting Profit (or Loss) of Group Entities located in that Jurisdiction after eliminating intra-Group transactions with Group Entities located in the same Jurisdiction, but before eliminating intra-Group transactions with Group Entities located in a different Jurisdiction, then the profits earned in that Jurisdiction are not substantially derived from transactions with other Group Entities in different Jurisdictions on the income-side of the business.

2091. The term *cross-border intra-group revenues* means the revenues included in calculating the Entity Financial Accounting Profit (or Loss) of a Group Entity and derived from transactions with Group Entities that are not located in the same Jurisdiction. This therefore relies on the term Entity Financial Accounting Profit (or Loss) as defined in Article 2, which means the profit or loss determined for an Entity (before any consolidation adjustments eliminating intra-Group transactions) in preparing Consolidated Financial Statements of the Covered Group. The definition therefore includes all revenue items derived by an Entity that are included in the calculation of the Entity Financial Accounting Profit (or Loss) to the extent that revenue is derived from transactions with Group Entities that are not located in the same Jurisdiction, and generally does not seek to isolate certain categories of intra-group revenues.

2092. The third condition in subdivision (iii) assesses the level of *cross-border intra-group expenses* of Group Entities located in the Jurisdiction relative to the total expenses of those Group Entities. This condition measures the level of integration on the cost-side of the business with Group Entities located in other Jurisdictions. In a case where *cross-border intra-group expenses* of Group Entities located in the Jurisdiction are at a low-level and do not exceed 15 per cent of the sum of the total expenses deductible in calculating the Entity Financial Accounting Profit (or Loss) of those Group Entities located in the Jurisdictions after eliminating intra-Group transactions with Group Entities located in the same Jurisdiction, but before eliminating intra-Group transactions with Group Entities located in a different Jurisdiction, then the profits earned in that Jurisdiction are not substantially derived from transactions with other Group Entities in different Jurisdictions on the cost-side of the business.

2093. The term *cross-border intra-group expenses* means the expenses deductible in calculating the Entity Financial Accounting Profit (or Loss) of a Group Entity and incurred in respect of transactions with Group Entities that are not located in the same Jurisdiction. This therefore relies on the term Entity Financial Accounting Profit (or Loss) as defined in Article 2, which means the profit or loss determined for an Entity (before any consolidation adjustments eliminating intra-Group transactions) in preparing Consolidated Financial Statements of the Covered Group. The definition therefore includes all expense items incurred by an Entity that are deductible in the calculation of the Entity Financial Accounting Profit (or Loss) to the extent those expenses are incurred in respect of transactions with Group Entities that are

not located in the same Jurisdiction, and does not generally seek to isolate certain categories of intra-group expenses.

2094. For the purpose of determining whether a Group Entity is located in a Jurisdiction under paragraph 2(a), the rules in Annex B Section 4(5) apply.

Box 33. Example – Application of paragraph 2(a)

Covered Group A carries on a business, in addition to other business lines, that is domestically and autonomously focused and that is operational in four Jurisdictions that are Parties: A, B, C and D.

In order to determine whether the adjustments in paragraphs 3 through 5 and paragraphs 11 through 12 should be made for the purpose of applying the Convention to Covered Group A for the Period, it should be assessed whether any of those four Parties qualify as an *autonomous domestic business jurisdiction* in respect of Covered Group A for the Period.

The test in subparagraph (a) includes three conditions, all of which need to be met.

Paragraph 2(a)(i): Deviation between revenues sourced and sum of Entity Financial Third-party Accounting Revenues

(EUR_m)	Party A	Party B	Party C	Party D
Sourced revenues	520	1000	100	150
Sum of Entity Financial Third-party Accounting Revenues	500	970	100	200
Sourced revenue as a percentage of sum of Entity Financial Accounting Revenues	104%	103%	100%	75%

In the case of Parties A, B and C, revenues sourced to each Party amount to between 95 and 105 per cent of the sum of the Entity Financial Third-party Accounting Revenues of Group Entities located in each Party. This means that substantially all Adjusted Revenues derived from those Parties are generated from sales to third parties located inside those Parties and that a limited amount of Adjusted Revenues are generated from third party sales outside of the those Parties.

In the case of Party D, the revenues sourced to that Party amount to only 75% of the sum of the Entity Financial Third-party Accounting Revenues of Group Entities located in that Party which does not fall between the allowed deviation of between 95% and 105%. This means that a substantial part of the Adjusted Revenues derived from Party D are generated from sales to third-parties outside of Party D (and are sourced to those locations).

This means that the first condition in paragraph 2(a)(i) is satisfied for Parties A, B and C and not for Party D.

Paragraph 2(a)(ii): Level of cross-border intra-group revenues relative to the total revenues

(EUR_m)	Party A	Party B	Party C	Party D
<i>Cross-border intra-group revenues</i>	50	30	10	177
Total revenues included in calculating the Entity Financial Accounting Profit (or Loss)	550	1000	110	377
Sum of <i>cross-border intra-group revenues</i> as a percentage of the sum of total revenues included in calculating the Entity Financial Accounting Profit (or Loss)	9%	3%	9%	N/A

The second condition in subparagraph (a)(ii) does not have to be assessed with respect to Party D because the first condition in subparagraph (a)(i) is not satisfied with respect to that Party.

In the case of Parties A, B and C, the sum of *cross-border intra-group revenues* of Group Entities located in those Parties are minimal relative to the sum of total revenues included in calculating the Entity Financial Accounting Profit (or Loss) of Group Entities located in those Parties and, as a result, do not exceed 15 per cent of the total revenues included in calculating the Entity Financial Accounting Profit (or Loss). This means the business of the Group in those Party is highly decentralised from the operations of the rest of the Group carried on in other Parties on the income-side as limited intra-group revenues are generated from cross-border sales.

This means that the second condition in subparagraph (a)(ii) is satisfied for Parties A, B and C. Paragraph 2(a)(iii): Level of cross-border intra-group expenses relative to the total expenses

(EUR_m)	Party A	Party B	Party C	Party D
<i>Cross-border intra-group expenses</i>	40	127	90	10
Total expenses deductible in calculating the Entity Financial Accounting Profit (or Loss)	350	850	105	310
Sum of <i>cross-border intra-group expenses</i> as a percentage of the sum of total expenses deductible in calculating the Entity	11%	15%	86%	N/A

Financial Accounting Profit (or Loss)				
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The third condition in subparagraph (a)(iii) does not have to be assessed with respect to Party D because the first condition in subparagraph (a)(i) is not satisfied with respect to that Party.

In the case of Parties A and B, the sum of *cross-border intra-group expenses* of Group Entities located in those Parties are minimal relative to the sum of total expenses deductible in calculating the Entity Financial Accounting Profit (or Loss) of Group Entities located in those Parties and, as a result, do not exceed 15 per cent of the total expenses deductible in calculating the Entity Financial Accounting Profit (or Loss). This means the business of the Group in those Party is highly decentralised from the operations of the rest of the Group carried on in other Parties on the cost-side and the value chain is substantially domestically focused and autonomous.

In the case of Party C, the sum of *cross-border intra-group expenses* of Group Entities located in those Parties are more substantial and exceed 15 per cent of the total expenses deductible in calculating the Entity Financial Accounting Profit (or Loss). This means that the business the Group performs in Party C is significantly integrated with the operations of the rest of the Group carried on in other Parties and that the business of the Group in Party C is not domestically focused on the cost-side.

This means that the third condition in subparagraph (a)(iii) is satisfied for Parties A and B and not for Party C.

Based on the application of the three conditions in subparagraph (a), Parties A and B each meet the definition of an *autonomous domestic business jurisdiction* under paragraph 2(a) in respect of Covered Group A. Parties C and D do not, in respect of Covered Group A.

2095. Where one or more Jurisdictions is an *autonomous domestic business jurisdiction* and therefore the adjustments in paragraph 4 are made to replace “Adjusted Profit Before Tax” and “Adjusted Revenues” with *non-domestic autonomous adjusted profit before tax* and *non-domestic autonomous adjusted revenues*, respectively, those adjustments solely apply for purposes of Article 5 concerning the allocation of Amount A Profit and for the “bottom-up” de minimis rule in paragraph 6. This means that the adjustments required under paragraph 4 do not apply for purposes of Article 3 which defines a Covered Group. Therefore, unlike the adjustments required under the exclusions in Section 2 which applies to a Group including one or more *regulated financial institutions* and Section 3 which applies in the case of a *qualifying extractives group*, the adjustments in Section 5 concerning the *autonomous domestic business exemption* do not require a “re-running” of the scope test in Article 3. A Group which is otherwise a Covered Group under Article 3, would solely fall out of scope under Section 5 where it meets either of the de minimis rules for scope in Section 5(6) or (7).

2096. This means there may be limited instances where one or more Jurisdictions is an *autonomous domestic business jurisdiction* in respect of a Covered Group and the conditions in paragraphs 6 and 7 are not satisfied, but there is nonetheless no Amount A Profit to allocate. Such a case would arise where the non-autonomous domestic part of the Covered Group does not earn a profit margin in excess of 10 per cent when only taking into account the *non-domestic autonomous adjusted profit before tax* and *non-*

domestic autonomous adjusted revenues. The result of this would be that there would be no Amount A Profit under Article 5 to allocate.

Paragraph 3

2097. Paragraph 3 contains the adjustments made in the cases that a Jurisdiction is an *autonomous domestic business jurisdiction* under paragraph 2(a) in respect of a Covered Group for a Period. In such cases, the adjustments contained in paragraph 3 exclude the financial results of the Covered Group derived from the Jurisdiction for purposes of allocation and elimination of double taxation.

2098. Subparagraph (a) adjusts the Elimination Profit (or Loss) of the Covered Group for the Period in the Jurisdiction that is an *autonomous domestic business jurisdiction* to zero for purposes of Annex B Section 4. Subparagraph (b) adjusts the *non-domestic autonomous adjusted revenues* of the Covered Group for the Period that are treated as arising in that Jurisdiction to zero. Subparagraph (c) adjusts the *jurisdictional depreciation and payroll* of the Covered Group for the Period in the Jurisdiction that is an *autonomous domestic business jurisdiction* to zero for purposes of Annex B Section 5. These adjustments mean that in a case where the business of the Covered Group in a Jurisdiction is sufficiently domestically and autonomously focused, such that the Jurisdiction meets the definition of *autonomous domestic business jurisdiction*, that Jurisdiction will not be allocated any Amount A Profit nor any obligation to relieve Amount A under the elimination of double taxation framework with respect to the Covered Group and that the Return on Depreciation and Payroll of the Covered Group for that Jurisdiction is not taken into account for purposes of Article 11 and for purposes of the *marketing and distribution profits safe harbour adjustment* in Article 5.

Paragraph 4

2099. Paragraph 4 contains the changes to terminology that are made for purposes of Amount A Profit and profit allocation under Article 5 in the case a Jurisdiction qualifies as an *autonomous domestic business jurisdiction* in respect of a Covered Group. This paragraph ensures that for purposes of applying the Convention the part of the Adjusted Profit Before Tax and of the Adjusted Revenues that are derived by an autonomous business in a Jurisdiction are not taken into account for purposes of allocating Amount A Profit. Instead, only amounts derived by the non-autonomous part of a business are taken into account, subject to the application of paragraphs 6 and 7 under which a Group could be excluded from scope. This effectively means that the autonomously and domestically focused part of a business in a Jurisdiction is treated as standalone businesses from any non-autonomous business of the Group in other Jurisdictions. This means the financial results of the autonomously and domestically focused business in a Jurisdiction are adjusted out of the consolidated financial statements of the Covered Group.

2100. These adjustments are made under subparagraphs (a) and (b) which provide for the replacement of terms for purposes of applying Article 5. Subparagraph (a) provides the Amount A Profit shall be determined by replacing, in Article 2(d), the term “Adjusted Profit Before Tax” with the term “non-domestic autonomous adjusted profit before tax” and by replacing the term “Adjusted Revenues” with the term “non-domestic autonomous adjusted revenues”. Subparagraph (b) provides the term Adjusted Revenues shall be replaced with the term *non-domestic autonomous adjusted revenues*.

2101. The term *non-domestic autonomous adjusted profit before tax* is defined in subparagraph (c) and relies on the separate terms *non-domestic autonomous financial accounting profit (or loss)*, to which the Adjusted Profit Before Tax adjustments identified in Article 4(1) are applied, and *non-domestic autonomous relevant net losses*. The *non-domestic autonomous financial accounting profit (or loss)* is defined in subparagraph (d) as the sum of *non-domestic autonomous adjusted revenues* and *non-domestic*

autonomous intra-group revenues after deducting *non-domestic autonomous expenses* and *non-domestic autonomous intra-group expenses*.

2102. The term *non-domestic autonomous adjusted revenues* is defined in subparagraph (e) and provides that revenues derived by the autonomous and domestically focused part of a Group are excluded from the Adjusted Revenues of the Group. The term *non-domestic autonomous intra-group revenues* is defined in subparagraph (f) and identifies revenues of the non-autonomous part of a Group derived from transactions with the autonomous part of the Group. Those revenues are included for purposes of calculating the *non-domestic autonomous financial account profit (or loss)* because they are derived by the non-autonomous part of the Group in respect of transactions with the domestic autonomous part of the Group (which is effectively treated as independent from the rest of the Group).

2103. The term *non-domestic autonomous expenses* is defined in subparagraph (g) and provides that expenses incurred by the autonomous part of a Group are excluded from the expenses of the Covered Group deducted in calculating the Covered Group's *non-domestic autonomous financial accounting profit (or loss)*. This means that only expenses incurred by the non-autonomous part of a Group are taken into account in calculating the Covered Group's *non-domestic autonomous financial accounting profit (or loss)*, subject to subparagraph (h). The term *non-domestic autonomous intra-group expenses* is defined in subparagraph (h) and identifies the expenses incurred by the non-autonomous part of a Group with the autonomous part of the Group. Those expenses are included for purposes of calculating the *non-domestic autonomous financial account profit (or loss)* because they are incurred by the non-autonomous part of the Group in respect of transactions with the domestic autonomous part of the Group (which is effectively treated as independent from the rest of the Group).

2104. The term *non-domestic autonomous relevant net losses* is defined in subparagraph (i). These are the losses to be carried forward and deducted in the calculation of the Covered Group's *non-domestic autonomous adjusted profit before tax* for a Period. The definition ensures that the calculation of *relevant net losses* for Groups that include an autonomous domestic business only includes the appropriate losses (i.e. excluding losses that relate to the autonomous domestic business). *Non-domestic autonomous relevant net losses* include the same two components as *relevant net losses* in the general rules under Annex B Section 2(3), except they are calculated with reference only to the appropriate losses. First, *non-domestic autonomous relevant net losses* always include the *non-domestic autonomous eligible net losses* (i.e. historical losses incurred within the Covered Group itself). Second, they can also include *transferred losses* (i.e. historical losses incurred by a separate business that has since been transferred to the Covered Group). Such *transferred losses* are calculated in accordance with the general rules in Annex B Section 2(3) (including as they relate to the modalities of lodging the election), but with reference only to the appropriate (i.e. non-domestic autonomous) losses of the *transferred group, entity or predecessor group*. This second part of the definition is only relevant if the Covered Group has made an election to recognise *transferred losses* in respect of a particular business combination or division. The same approach is taken with respect to the regulated financial services and extractives exclusions. See the Explanatory Statement to Annex B Section 2(3) for further detail.

2105. The term *non-domestic autonomous eligible net losses* is defined in subparagraph (l). This follows the definition of *eligible net losses* in Annex B Section 2(5)(a), but ensures that only losses that are not derived from an autonomous domestic business are included in the calculation.

2106. The term *non-domestic autonomous eligible prior period* is defined in subparagraph (j). This follows the definition of *eligible prior period* in Annex B Section 2(5)(b), except that it applies by reference to *non-domestic autonomous unused losses*. This ensures that only those losses that are not derived from an autonomous domestic business are captured.

2107. The term *non-domestic autonomous unused loss* is defined in subparagraph (k). This follows the definition of *unused loss* in Annex B Section 2(5)(h), except the amount is calculated by reference to the *non-domestic autonomous financial accounting profit or loss* of prior Periods (i.e. removing the profits and losses derived from an autonomous domestic business).

Paragraph 5

2108. Paragraph 5 provides for the replacement of the terms *accounting depreciation* and *accounting payroll* or the purpose of determining the Elimination Threshold Return on Depreciation and Payroll in Article 2(n) with the terms *non-domestic autonomous accounting depreciation* and *non-domestic autonomous accounting payroll*, respectively.

2109. The replacement of terminology under paragraph 5 ensures that *accounting depreciation* and *accounting payroll* that are taken into account for determining the financial results of the autonomously and domestically focused part of a Covered Group are not taken into account for purposes of determining the Elimination Threshold Return on Depreciation and Payroll of a Covered Group. Rather, this means the Elimination Threshold Return on Depreciation and Payroll of a Covered Group, which applies for purposes of the *marketing and distribution profits safe harbour adjustment* under Article 5(2)(c) and for purposes of the calculation of the obligation to eliminate double taxation under Article 11(11) through (14), is determined by reference to *accounting depreciation* and *accounting payroll* to the extent those relate to financial results of the non-autonomous domestic business part of a Covered Group.

Paragraph 6

2110. Paragraphs 6, read together with Article 3(7), contains the first de minimis rule for scope purposes, which provides an exception to the general operation of the scope rules in Article 3. Under paragraph 6, a Group that is otherwise a Covered Group shall not be treated as a Covered Group in the Period if the *non-domestic autonomous adjusted profit before tax* of the Group for the Period, as determined under paragraph 4, is less than 10 per cent of the Adjusted Profit Before Tax of the Group for the Period, before making the adjustments under paragraph 4.

2111. This paragraph recognises that where Amount A Profits are substantially already in the market, the administrative burden associated with applying the provisions of the Convention in full may be excessive and disproportionate compared to the benefit of applying Amount A, and therefore justify an exclusion of the Group from the scope of the Convention.

2112. The approach taken under paragraph 6 is a “bottom-up” approach as it builds up from and relies on the adjustments under paragraph 4. It consists of two steps:

- First, under paragraph 4, by excluding the profits of the Covered Group derived from an *autonomous domestic business jurisdiction* from the Adjusted Profit Before Tax; and
- Second, after applying paragraph 4, by assessing whether the *non-domestic autonomous adjusted profit before tax* falls below a de minimis threshold of 10 per cent of the Adjusted Profit Before Tax (prior to applying the adjustment in paragraph 4) and, if so, exclude the Group from scope.

Box 34. Example – Application of paragraph 6

Covered Group B, which is operational in Parties E, F, G and H, has an Adjusted Profit Before Tax for the Period equal to EUR 1.5 billion.

Jurisdictions E, F and H qualify as an *autonomous domestic business jurisdiction* under paragraph 2(a) in respect of Covered Group B.

After making the adjustments provided in paragraph 4, EUR 1.45 billion of profit relating to the *autonomous domestic business jurisdictions* is excluded from the Adjusted Profit Before Tax of Covered Group B and, as a result, its *non-domestic autonomous adjusted profit before tax* for the Period equals EUR 50 million (see table below).

The *non-domestic autonomous adjusted profit before tax* for the Period of EUR 50 million represents c.3 per cent of the Adjusted Profit Before Tax of Covered Group A, which is below the de minimis threshold in paragraph 6 of 10 per cent.

This means that Covered Group B will not be treated as a Covered Group for the Period under paragraph 6.

(EUR_mn)	Party E	Party F	Party G	Party H
Contribution to Adjusted Profit Before Tax	900	450	50	100
Is the Party an autonomous domestic business jurisdiction?	Yes	Yes	No	Yes
Contribution to <i>non-domestic autonomous adjusted profit before tax</i>	-	-	50	-

2113.

Paragraphs 7 and 8

2114. Paragraph 7, read together with Article 3(7), contains the second de minimis rule for scope purposes which provides an exception to the general operation of the scope rules in Article 3. Under paragraph 7, a Group that is otherwise a Covered Group shall not be treated as a Covered Group in the Period if either of the relevant conditions in subparagraph (a) or (b) are met.

2115. The approach taken under paragraph 7 is a “top-down” approach as it applies irrespective of whether the adjustments in paragraphs 3 through 5 apply. This means that it is not required for a Jurisdiction to qualify as an *autonomous domestic business jurisdiction* in respect of a Covered Group for a Period for the purpose of applying paragraph 7. As is the case with paragraph 6, paragraph 7 recognises that where Amount A Profits are substantially already in the market, the administrative burden associated with applying the administrative rules, including the adjustments in paragraphs 3 through 5, may be excessive and disproportionate compared to the benefit of applying Amount A, and therefore justify an exclusion of the Group from the scope of the Convention.

2116. The top-down approach to a de minimis rule for scope under paragraph 7 contains two sets of rules which are alternatives, and it would be sufficient for a Group to meet either of the conditions included in subparagraph (a) or (b) for the Group to be out of scope of the Convention.

Subparagraph (a)

2117. The rule in subparagraph (a) is targeted at Groups that operate as domestic businesses exclusively, or almost exclusively, in a single Jurisdiction. This paragraph includes four conditions in subdivisions (i)-(iv) that must be met:

2118. First, subdivision (i) requires that at least 90 per cent of the Adjusted Revenues of the Group are sourced to a single Jurisdiction and, additionally, the remaining amount of the consolidated revenues are not concentrated in another Jurisdiction, by requiring that no more than 5 per cent of the Adjusted Revenues of the Group are sourced to another single Jurisdiction.

2119. Second, subdivision (ii) requires that the *group revenue delta* for the Period, as defined in paragraph 8, is less than 10 per cent of the Adjusted Revenues of the Group. This means the level of deviation at a jurisdictional level between the Entity Financial Third-party Accounting Revenues (as defined in Article 2) and the revenues sourced to a Jurisdiction under Article 6, relative to the Group’s Adjusted Revenues, does not exceed 10 per cent.

2120. Paragraph 8 provides the definition of the term *group revenue delta* which is calculated at Group level by summing the level of deviation between third-party booked revenue and sourced revenue at a Jurisdictional level. Specifically, by summing the result of deducting the *Entity Financial Third-Party Accounting Revenues* of Group Entities located in a Jurisdiction from the revenues that are treated as arising in that Jurisdiction (i.e. the difference between jurisdictional third-party booked revenue and jurisdictional sourced revenue) to the extent that the deduction results in an amount that is greater than zero. In order to avoid potential double-counting of revenues that are booked in a Jurisdiction but sourced to other Jurisdictions, the term *group revenue delta* only sums the result of deducting booked revenue at a jurisdictional level from sourced revenues at a jurisdictional level where the result is greater than zero.

2121. Subdivision (ii) thus assesses the level of autonomy of the operations of a Group on the income-side of the business. Specifically, whether the Group is selling locally to third parties (i.e. “local sales”) or regularly sells cross-border to third parties. In cases where the *group revenue delta* is minimal and less than 10 per cent of the Adjusted Revenues of the Group, this means the Group is substantially generating all of its revenues through local sales.

2122. Third, subdivision (iii) requires that *cross-border intra-group revenues* do not exceed 25 per cent of the total revenues included in calculating the Financial Accounting Profit (or Loss) of the Group. This subdivision therefore assesses the level of autonomy of the operations of a Group across different Jurisdictions on the income-side of the business with respect to cross-border intra-group income. The term

cross-border intra-group revenues is defined in subparagraph 2(b) (see paragraph 2091 of this Explanatory Statement for further details).

2123. Fourth, subdivision (iv), assesses the level of *cross-border intra-group expenses* of the Group relative to the total expenses deductible in calculating the Financial Accounting Profit (or Loss) of the Group. Where the *cross-border intra-group expenses* of the Group are at a low-level and do not exceed 25 per cent of the total expenses, then the profits of the Group are not substantially derived from integrated operations in different Jurisdictions on the cost-side and subdivision (iv) will be met. The term *cross-border intra-group expenses* is defined in subparagraph 2(c) (see paragraph 2093 of this Explanatory Statement for further details).

Subparagraph (b)

2124. The rule in subparagraph (b) is targeted at Groups operating in multiple jurisdictions through highly decentralised business models. This paragraph includes three conditions in subdivisions (i) through (iii) that must be met:

2125. First, subdivision (i) requires that the *group revenue delta* defined in paragraph 8 does not exceed 15 per cent of the Adjusted Revenues of the Group. This condition therefore mirrors the condition in subparagraph (a)(ii) but, rather than a 10 per cent threshold, a 15 per cent threshold applies under this subdivision. With the exception of the modified threshold, paragraph 2090 of this Explanatory Statement applies.

2126. Second, subdivision (ii) contains a safeguard to supplement subdivision (i) and prevent a potential risk of “jurisdictional blending” where material deviations between third party accounting revenues and sourced revenues in certain (potential smaller) Jurisdictions are not recognised under subdivision (i) because of jurisdictional blending at the level of the Group. The result is that the top-down rule for the decentralised business model is switched-off where the conditions provided in paragraph 2(a)(i) and (ii) (which apply to revenues) are not met in one or more Jurisdictions in which the Group operates and the sum of the Adjusted Revenues of the Group sourced to those jurisdictions that fail the conditions in paragraph 2(a)(i) and (ii) represents at least:

- 5 per cent of the Adjusted Revenues of the Covered Group for the Period in cases where the Group has Adjusted Revenues that are greater than EUR 100 billion for the Period; or
- 35 per cent of the Adjusted Revenues of the Covered Group for the Period in cases where:
 - the Group has Adjusted Revenues that are less than EUR 50 billion and those Adjusted Revenues, under Article 6, are treated as arising in at least thirty Jurisdictions; and
 - the result of subtracting 10 per cent of the Adjusted Revenues of the Group for the Period from the Adjusted Profit Before Tax of the Group and multiplying the result of the subtraction by 25 per cent, is less than EUR 500 million. This calculation effectively mirrors the calculation provided in Article 5(1)(a) and(b) to calculate the “gross” Amount A of the Covered Group prior to applying the Marketing and Distribution Safe Harbour Adjustment; or
- 15 per cent of the Adjusted Revenues of the Covered Group for the Period in all other cases.

2127. Third, subdivision (iii) requires that the sum of *cross-border intra-group expenses* of Group Entities for the Period does not exceed 25 per cent of the total expenses deductible in calculating the Financial Accounting Profit (or Loss) of the Covered Group for the Period. This subdivision therefore mirrors the condition in paragraph 7(a)(iv) and paragraph 2123 of this Explanatory Statement is therefore applicable.

Box 35. Example – Application of paragraph 7(b)

Covered Group C carries on a business that is operational in four Jurisdictions that are Parties: A, B, C and D, and that is domestically and autonomously focused in each such Jurisdiction.

In order to determine whether Covered Group C shall not be treated as a Covered Group in the Period, the three conditions in paragraph 7(b) have to be assessed.

Subdivision (i): group revenue delta as defined in paragraph 8

(EUR_bn)	Party A	Party B	Party C	Party D
Sourced revenues	10	25	40	20
Entity Financial Third-party Accounting Revenues	13	24	38	20
Sourced revenues minus Sum of Entity Financial Third-party Accounting Revenues, or zero if higher	0	1	2	0

EUR 13 billion of Covered Group C's revenues are booked (sum of Entity Financial Third-party Accounting Revenues) in Party A, but EUR 3 billion of those booked revenues are not sourced to that Party. Instead, EUR 1 billion are sourced to Party B, and EUR 2 billion being sourced to Party C.

In order to avoid potential double-counting of the EUR 3 billion of revenues that are booked in Party A but sourced to other Parties, the term *group revenue delta* only sums the result of deducting booked revenue at a jurisdictional level from sourced revenues at a jurisdictional level where the result is greater than zero.

In the case of this example, the delta in Party B and Party C between sourced revenues and Entity Financial Third-party Accounting Revenues should be added together to calculate the Covered Group B's *group revenue delta* for the Period of EUR 3 billion (i.e. EUR 1 billion + EUR 2 billion).

Covered Group C's *group revenue delta* for the Period of EUR 3 billion represents 3% of the Adjusted Revenues of Covered Group C of EUR 95 billion, which is below the de minimis threshold in subparagraph 7(b)(i) of 15 per cent. This means that substantially all Adjusted Revenues derived from those Parties generated from sales are to third parties located in those Parties and that a limited amount of Adjusted Revenues are generated from third party sales outside of those Parties.

Subdivision (ii): Anti-blending test

The jurisdictional deviation between third-party sourced revenues and booked revenues for Parties A – D is 33%, 4%, 5% and 0%, respectively (see table above).

This means that only Party A fails the condition in paragraph 2(a)(i), which allows for a 5% deviation. The condition in paragraph 2(a)(ii) does not have to be assessed in this example for purposes of the anti-blending test because it is sufficient for a Party to fail either the condition in paragraph 2(a)(i) or

paragraph 2(a)(ii) for that Party to be relevant for the conditions in subdivision (ii)(A) - (C).

The Adjusted Revenues that are treated as arising in Party A are EUR 10 billion, which represents 11% of the Adjusted Revenues of Covered Group C, do not exceed the 15% threshold in subdivision (ii)(C). The conditions in subdivision (ii)(A) and (ii)(B) do not apply this example.

Subdivision (iii): Level of cross-border intra-group expenses relative to the total expenses

(EUR_bn)	Party A	Party B	Party C	Party D
Sum of cross-border intra-group expenses	8	3	4	2
Total expenses deductible in calculating the Financial Accounting Profit (or Loss)	75			

The sum of *cross-border intra-group expenses* of the Group Entities of Covered Group C for the Period equals EUR 17 billion, and Covered Group C's total expenses deductible in calculating the Financial Accounting Profit (or Loss) equal EUR 75 billion.

Therefore, the sum of *cross-border intra-group expenses* amount to 23% of the total expenses deductible in calculating the Financial Accounting Profit (or Loss) which does not exceed the 25% threshold in subparagraph 7(b)(iii).

Considering the conditions in subdivisions (i) – (iii) are all satisfied, Covered Group C will not be treated as a Covered Group for the Period.

Paragraph 9

2128. Paragraph 9 applies to a Covered Group for which a Jurisdiction was an *autonomous domestic business jurisdiction* in a prior Period, but for which it is not an *autonomous domestic business jurisdiction* in the Period. Paragraph 9 makes adjustments to the calculation of *relevant net losses* in prior Periods to exclude *non-domestic autonomous relevant net losses* relating to an *autonomous domestic business jurisdiction* where those amounts are relevant to the Period. The term *relevant net losses* is replaced with the term *non-domestic autonomous relevant net losses*. This ensures that losses in prior Periods that derive from an *autonomous domestic business jurisdiction* are not deducted from the Adjusted Profit Before Tax in the Period. The term *non-domestic autonomous relevant net losses* is defined in subparagraph 4(i).

Paragraph 10

2129. Paragraph 10 contains a stabilisation mechanism that applies for purposes of paragraph 2(a) that provides that a Jurisdiction which has a stable and consistent history of satisfying the three conditions in the entry test, is permitted to fail the condition in paragraph 2(a)(i) by a narrow margin for a single “grace” Period and still meet the definition of *autonomous domestic business jurisdiction* during that Period.

2130. Paragraph 10 is therefore only relevant where a Jurisdiction is not otherwise an *autonomous domestic business jurisdiction* in a Period, and the exceptional “grace period” provided is subject to three conditions:

- First, it is only available for Jurisdictions that have met the entry test in paragraph 2(a) for the five consecutive prior Periods preceding the Period where it does not otherwise meet the conditions in paragraph 2(a);
- Second, the Jurisdiction would satisfy the condition in paragraph 2(a)(i) if the 95 per cent and 105 per cent threshold figures in that subdivision were replaced with 94 per cent and 106 per cent, respectively, for the Period. This requirement effectively means a Jurisdiction can only narrowly fail the sourced revenues and financial third-party accounting revenues comparison contained therein; and
- Third, the Jurisdiction satisfies the conditions in paragraph 2(a)(ii) and (iii) for the Period.

2131. Where the above conditions are satisfied, the Jurisdiction is deemed to meet the definition of *autonomous domestic business jurisdiction* in the Period and would therefore apply the adjustments in paragraphs 3-5 and 11-12 and the Covered Group would apply the de-minimis scope exclusion in paragraph 6 taking account of the deeming provision under paragraph 10.

2132. However, the test of the term of five consecutive prior Periods would then be reset and start again in the next Period. This means that where such a Jurisdiction again fails the entry test in any of the five Periods that follow the Period in respect of the same Covered Group, the deeming rule would not apply. This means the adjustments in paragraphs 3-5 and 11-12 would not be made in respect that Jurisdiction, and this would flow through to the de-minimis rule for scope in paragraph 6. The deeming rule could at the earliest apply again in the sixth Period that follows the Period and only where the Jurisdiction passed the entry test in paragraph 2(a) for the five Periods that follow the Period.

Paragraphs 11 through 13

2133. Paragraph 11 provides that the obligation of a Jurisdiction to eliminate double taxation with respect to a portion of the *Amount A relief amount* under Article 11 shall be the lower of two calculations:

- Subparagraph (a): the calculation of the amount of relief allocated to a *relieving jurisdiction* prior to identifying *autonomous domestic business jurisdictions* and applying Section 5; and
- Subparagraph (b): the calculation of the amount of relief allocated to the *relieving jurisdiction* after identifying *autonomous domestic business jurisdictions* and applying Section 5.

2134. This adjustment only applies where at least one Jurisdiction is an *autonomous domestic business jurisdiction* in respect of a Covered Group for a Period and the Group is a Covered Group in the Period as the conditions in paragraphs 6 and 7 are not satisfied (as in cases where either of those paragraphs are satisfied, the Group would not be a Covered Group, and therefore there would be no obligation to eliminate double taxation for Amount A purposes).

2135. Where the outcome under paragraph 11 is that the amount calculated under paragraph 11(b) is higher than the amount calculated under paragraph 11(a) for at least one Jurisdiction, paragraph 12 provides that the Amount A Profit of a Covered Group that is allocated to a Jurisdiction for a Period under Article 5 shall be reduced by deducting the product of multiplying the *non-domestic autonomous Amount*

A *relief amount adjustment* by the Amount A Profit allocated to the Jurisdiction prior to applying paragraph 12, divided by the total Amount A Profit available for reallocation prior to applying paragraph 12.

2136. Paragraph 13 provides the definition of the term *non-domestic autonomous Amount A relief amount adjustment* for purposes of paragraph 12. This is calculated at Group level by adding together the results of deducting the amount calculated under subparagraph 11(a) for a Jurisdiction from the amount calculated under 11(b) for the Jurisdiction (i.e. the difference for each *relieving jurisdiction* arrived at under paragraph 11) to the extent that the deduction results in an amount that is greater than zero.

Box 36. Example – Application of paragraphs 11 and 12

Covered Group A operates in multiple Jurisdictions including Parties A, B and C, which are each *relieving jurisdictions* prior to the application of the autonomous domestic business exemption in Section 5, and Party D, which is not a *relieving jurisdiction* prior to the application of Section 5, but is a *relieving jurisdiction* after its application where Party A meets the definition of *autonomous domestic business jurisdiction* for the Group for the Period.

Paragraph 11

Step 1 – calculate the allocation of the obligation to eliminate double taxation with respect to Amount A prior to applying the autonomous domestic business exemption under subparagraph (a): the total Amount A Profit reallocated to market jurisdictions is 1000, where Party A relieves 100, Party B relieves 450, Party C relieves 450 and Party D relieves 0.

Step 2 calculate the allocation of the obligation to eliminate double taxation with respect to Amount A after applying the autonomous domestic business exemption under subparagraph (b): with Party A removed, relief allocated to Party B increases to 490, Party C also now relieves 490 and Party D is identified as a *relieving jurisdiction*, relieving 20.

The adjustments made under paragraph 11 mean that the amount of relief provided by Parties B, C and D would equal the amounts calculated under subparagraph (a) as those are lower than the amounts calculated under subparagraph (b) for those Parties.

Paragraph 12

The Amount A Profit of Covered Group A that is allocated to a Party under Article 5 will be reduced by the result of the following calculation:

- multiplying the *non-domestic autonomous Amount A relief amount adjustment* which is equal to 100 (i.e. 40 for Party B + 40 for Party C + 20 for Party D) by
- the Amount A Profit of Covered Group A for the Period that would otherwise be allocated to the Party under Article 5 before applying paragraph 12, divided by
- the total Amount A Profit of Covered Group A under Article 5 before applying paragraph 12.

Section 6 – Defence groups adjustment

Paragraph 1

2137. Paragraph 1 requires that the adjustments described in paragraph 2 of this Annex shall be made for a Covered Group that is a *defence group* in a Period.

Paragraph 2

2138. Paragraph 2 replaces the terms used in the Convention for the purpose of applying the Convention to a Group that would be a Covered group for a Period under Article 3 and that is a *defence group*. The adjustments in paragraph 2 do not apply for the purposes of Article 3, i.e., the determination of whether a Group is a Covered Group, or not, is made without using the replacement terms, *non-defence adjusted profit before tax* and *non-defence adjusted revenues*, even if the Group is a *defence group*. There are two prerequisites for applying the adjustments. First, that the Group must first have met the scope thresholds that apply to all Groups, as set out in Article 3. If a Group is not in scope under the ordinary scope thresholds, there is no cause for applying the defence adjustment. Second, that the Group is a *defence group* (defined in paragraph (3)). The purpose of this enquiry is not to quantify the relative size of the defence business vis-à-vis any other parts of the Group, but to determine whether the Group is eligible for the adjustment.

2139. The effect of paragraph 2 is to adjust the revenue and profit (or loss) of a *defence group* and to apply the Convention to the remaining non-defence revenue and profits of the Group. Paragraph 2 also replaces the relevant terms to ensure that the elimination of double tax calculations and obligations only apply with respect to non-defence revenues and profits. Paragraph 2 also provides for the application of the ordinary rule on *unused losses*, but only with respect to losses incurred in connection with non-defence.

2140. After applying the adjustments, the rest of the Convention applies, but only with respect to the non-defence portion of the Group. This is different to the approach taken to the exclusions that apply for a group that includes a *regulated financial institution* or a *qualifying extractives group*. In those cases, after the application of the exclusion, the scope thresholds contained in Article 3 are re-applied to determine whether the Group is in scope having regard only to the non-*regulated financial institution* or non-extractives portion of the Group. In the case of a *defence group*, once the Group has met the scope thresholds contained in Article 3 on a consolidated basis (i.e. before adjusting for defence), the Group remains in scope irrespective of the size of the adjustment for defence. This is subject to a limited de minimis rule in paragraph 4 of the Annex, described below. However, the rest of the Convention will only apply with respect to the non-defence portion. For example, the nexus test and revenue sourcing rules are only applied with respect to non-defence revenues; the formula for the allocation of profits is only with respect to non-defence profits; the marketing and distribution safe harbour only applies with respect to non-defence revenues; and the calculations and obligations related to elimination of double taxation only apply with respect to non-defence profits. This also means there may be instances where a Covered Group is a *defence group* and the de minimis rules for scope in paragraph 4 does not apply, but there is nonetheless no Amount A Profit to allocate. Such a case would arise where the non-defence part of the Covered Group does not earn a profit margin in excess of 10 per cent when only taking into account the non-defence adjusted profit before tax” and “non-defence adjusted revenues”. The result of this would be that there would be no Amount A Profit under Article 5 to allocate. Special provisions also apply in the context of tax certainty and administration to ensure that sensitive information related to *defence groups* is not disclosed.

2141. Article 3(4) and (5) also make provision for an exclusion in respect of a group that includes a *regulated financial institution* and for a *qualifying extractives group*. In the case of a *defence group* that is also eligible for one or both of those other exclusions, Article 3(4), (5) and (8) can apply. Such a group may apply the exclusions in any order, with the cumulative result that only the non-regulated financial services

and non-extractives and non-defence part of the Group can be subject to the remaining provisions of the Convention. However, if the Group is not in scope of the Convention after the application of one or two of those exclusions, it would not need to apply the other exclusion(s).

Paragraph 3

2142. Paragraph 3 sets out the meaning of the replacement terms. Three of those terms set out the meaning of defence (“defence group”, “defence purpose” and “defence revenues.”) The rest of the terms provide adjustments to identify the non-defence revenues, non-defence profits, non-defence losses, and non-defence revenues and profits relevant for calculating the elimination of double taxation. The adjustments are all performed on a pro-rata basis, using the proportion of the defence revenues to the total revenues as the *allocation factor*. While this is a proxy for identifying the non-defence portion of the Group, this is done to prevent the disclosure of sensitive information that may implicate wider policy issues.

2143. Paragraph (a) defines the term “defence group”. It means a Group that derives *defence revenues*. This means that a Group that is deriving any level of defence revenues is a *defence group*, whether it is the main activity of the Group or one of many activities it conducts.

2144. Paragraph (b) defines the term “defence purpose”. It defines the types of supply that can be treated as having a *defence purpose*. That purpose can be satisfied in one of two ways. The reference to supply is broad, and would include all categories covered by the revenue sourcing rules (e.g. finished goods and components, digital content, as well as services such as *location-specific services* and other services and *intangible property*).

2145. Both of the sub-categories of *defence purpose* draw on the phrases “defence or intelligence services” and “security interests preserved by defence or intelligence services”. The term “defence” refers to the authorised military or armed forces of a sovereign jurisdiction. This includes national military efforts that are intrinsic to the exercise of the sovereign function of a Jurisdiction in ensuring the safety or protection of a Jurisdiction and its citizens from attack or aggression by persons of another Jurisdiction. It also includes international defence that serves a similar purpose as those national military efforts, but where there is more than one Jurisdiction acting or whose interests are involved, such as under the auspices of regional or supra-national organisations. Intelligence services refers to the provision of information, research, analysis and advice related to threats of attack or aggression by persons of another Jurisdiction. “Defence or intelligence services” does not include a government’s domestic policies directed at promoting economic well-being, health, protection of economic and financial interests or industrial competitive advancement, or matters of domestic peace and good government such as civil emergency and law enforcement services. “Security interests preserved by defence or intelligence services” refers to national and international security interests that are the responsibility of defence and intelligence services. It therefore would not cover interests related to, for example, energy security or economic security.

2146. The first way of satisfying the *defence purpose* test is included in subdivision (i), and it has two conditions.

2147. The first condition requires that the procuring party or user of the supply is a *specified government body*. See discussion of that defined term below. This element would cover direct sales of defence supplies to a *specified government body*, irrespective of whether that procuring *specified government body* further provides the supplies to another government or international agency (sometimes referred to as “foreign military sales”).

2148. It can also cover indirect sales to *specified government body*, such as would be the case for components that otherwise meet the description in sub-conditions (A) or (B) (discussed below) but that are

sold to another business but ultimately are incorporated into supplies that have a *defence purpose*. This is addressed by reference to the language of the “user of the supply”. In this context, the user can be the immediate procuring party or the end user of the supply. For example, if a Covered Group sold an aircraft engine of a type that met the description in sub-conditions (A) or (B) of the definition to an aircraft manufacturer for incorporation into military aircraft, the end user of that supply would be expected to be a *specified government body*.

2149. This requirement that the procuring party or user is a *specified government body* is included to address the issue of dual use supplies in particular, where a wider range of supplies may be of a technical standard that makes them subject to the relevant regulation that would satisfy sub-condition (B) (discussed below), but the definition of *defence purpose* will only extend to those that are actually acquired by a *specified government body* or for use by a *specified government body* (rather than applying to commercial supplies that could be, but are not in practice, used for a *defence purpose*).

2150. The second condition in subdivision (i) can be satisfied through one of two alternative sub-conditions, at least one of which must be met. The first alternative sub-condition (A) requires that the supply must be designed for use by defence or intelligence services. This will be satisfied if it is specifically designed or modified to be used in military efforts or intelligence services or is technically able to meet the specifications required in the context of national or international defence or intelligence. This means that there must be something about the design of the supply to indicate that it was solely or primarily intended for use in military or intelligence efforts. This means it does not include supplies without specific design or modification or technical specification relevant for the military context but happen to be provided to a defence or intelligence agency. For example, the condition would generally not be satisfied in respect of items primarily designed for use by commercial businesses or civilians such as office supplies, standardised software and cloud services also sold to the general public, fuel for vehicles also used as civilian transport, telecommunications services, food and beverage, non-military vehicles and replacement parts, cleaning products, office premises, utilities such as internet and electricity, mobile phones, non-specialised clothing and footwear. It may be necessary for the Conference of the Parties to provide further guidance on this issue, including as the nature of the defence and intelligence sector evolves over time.

2151. Common examples of a supply designed for use by defence or intelligence services include weapons, ammunition, military vehicles, military vessels, military aircraft, rockets, explosive devices and explosives, military training equipment, military training, military protective equipment, missile protection systems, missile guiding systems, military surveillance and warning systems, services to research, test, install, maintain, or provide training with respect to the foregoing, and software and components that have specific design elements that make them suitable for being incorporated into the foregoing.

2152. In the alternative, the second sub-condition (B) requires that that the provision of the supply is of a type that would be subject to export control regulation designed to protect security interests preserved by defence or intelligence services. This means that if the supply were to be exported, then it is of a type that would have been subject to such controls. This refers to regulation specifically relevant to the export of items used in military efforts and by intelligence services, and not regulation of a more general nature such as consumer protection regulation or general procurement rules that apply to a *specified government body*. It includes regulation implementing the requirements of international agreements such as the Wassenaar Arrangement and the Missile Technology Control Regime. This type of regulation limits, controls or requires special licences or authorisations for the export of military items or weapons. Such regulation is generally updated frequently, including to account for advances in technology, and the reference to regulation in the Convention includes such updates. While there may be different levels of restriction in the relevant regulation, the requirement in the Convention is that the supply would be subject to any level of such controls (i.e. it does not require that the supply be subject to the strictest level of control).

2153. This regulation also covers supplies which are “dual use” supplies that are subject to export control regulation designed to protect security interests preserved by defence or intelligence services. This is a supply that may be capable of use in both commercial and defence or intelligence contexts, such as an engine component that could be included in a commercial aircraft and that could also be included in an aircraft used by a national military air force. These supplies will not be able to meet condition (A), and as such can only be within the meaning of *defence purpose* if they meet the regulation test in (B) subject to satisfying the procuring party / user condition. By way of illustrative example, a regulation based on the Wassenaar Arrangement would generally satisfy condition (B) because a regulation based on the Wassenaar Agreement would not cover items that are not of particular relevance to the defence or intelligence context. Further, supplies such as software generally available to the public, radio equipment specially designed for use with either civil cellular radio-communications systems, fixed or mobile satellite earth stations for commercial civil telecommunications, television or video cameras specially designed for television broadcasting, scanning cameras or equipment specially designed for industrial or civilian photocopiers or medical equipment, aircraft and aero engines for civil aircraft, food, beverages, office equipment or vehicles designed for use by civilians would not be within the meaning of defence, if such supplies would fail the regulation test (and would have failed condition (A)).

2154. The second way of satisfying the *defence purpose* test is included in subdivision (ii). This is a separate, standalone test for items that can meet the *defence purpose* test, and does not require that the procuring party or user of the supply is a *specified government body*. This applies where the disclosure of information related to the supply is prohibited by law designed to protect security interests preserved by defence or intelligence services. This refers to laws (including primary legislation as well as delegated legislation including regulation and other legal instruments) that classify information and the disclosure of which would subject a person to criminal penalties. This means it cannot be claimed in respect of transactions the details of which (including nature of the supply and purchasing party or user) are already disclosed publicly, for example in Consolidated Financial Statements or in public procurement reports, nor can it be claimed where details of the transaction are subject to ordinary contractual obligations to refrain from disclosing information obtained in the course of employment (unless such information is also subject to such disclosure of information laws).

2155. In condition 3(b)(ii), the reference to the legal provision governing prohibition on disclosure of information is any that applies to the supply, whether in the place of residence of the ultimate parent entity of the Group (and which therefore has authority to regulate and supervise the provision of defence supplies), or a *specified government body* that is the procuring government of the defence supplies in question (if different). If the legal prohibition applies in either of those Jurisdictions, then the condition is met. In other words, a match between the information disclosure laws on both sides of a supply is not required. A *specified government body* or other government body that is the place of residence of the Ultimate Parent Entity of the Group may make this claim on behalf of the purchasing *specified government body*, provided it has reviewed the relevant documentation to be able to confirm those details. Alternatively, it may be necessary that both government bodies of the residence and purchaser) would need to make such a claim in respect of different supplies, if they do not have full information on the totality of the supplies.

2156. Subparagraph (c) defines the term “defence revenues”. It means the revenues earned in providing a supply that has a *defence purpose*.

2157. Subparagraph (d) defines the term “defence segment”. This refers to any *disclosed segment* for which any of the revenues reported by that *disclosed segment* and that are included in the Consolidated Financial Statements of the Group for the Period are *defence revenues*.

2158. Subparagraph (e) defines the term “non-defence adjusted profit before tax”. This term is relevant for allocating the non-defence profits of the Group to the market. The definition follows closely the

mechanism in Annex B Section 2 to make adjustments to the tax base, and to deduct *non-defence relevant losses*, except that it is based on the Covered Group's *non-defence financial accounting profit (or loss)*. The adjustments required for the tax base are only made to the extent they relate to the non-defence revenues. Where the pro rata adjustment has been made as required by the other definitions in paragraph 2, that same pro rata adjustment is made with respect to the required tax base adjustments (as opposed to a bespoke adjustment identifying whether items relate to the *defence revenues* or not). In respect of a *disclosed segment* that is not a *defence segment*, and where the disclosed segment approach has been used in calculating the *non-defence financial accounting profit (or loss)*, the tax base adjustments are made specifically to the results reported in that *disclosed segment*.

2159. Subparagraph (f) defines the term “non-defence adjusted revenues”. This term is relevant as the basis for determining and allocating the amount of *taxable profit* of a Covered Group that is a *defence group*. *Non-defence adjusted revenues* of a Group for a Period means the Adjusted Revenues of the Group for the Period modified to exclude all revenues that are *defence revenues*. By starting with the defined term ‘Adjusted Revenues’ of the Group (i.e. the term as generally used throughout the Convention, rather than that term as replaced in Annex C Section 6) it means that the term *non-defence adjusted revenues* only excludes *defence revenues* that were otherwise included in the Consolidated Financial Statements (i.e. third party revenues).

2160. Subparagraph (g) defines the term “non-defence eligible net losses”. This definition follows that found in Annex B Section 2(5)(a), but ensures that only losses from non-defence activities are included in the calculation.

2161. Subparagraph (h) defines the term “non-defence eligible prior period”. This definition follows that found in Annex B, Section 2(5)(b), but applies by reference to *non-defence unused losses*. This ensures that only those losses related to non-defence activities are captured.

2162. Subparagraph (i) defines the term “non-defence entity depreciation”. This term is relevant for calculating the elimination of double taxation obligations, which are performed on an entity and jurisdictional basis. It means the *entity depreciation* that would otherwise be determined under Annex B Section 5(5)(b) multiplied by the non-defence revenue as a proportion of total revenue calculated in paragraph 3(k)(i) and (ii). In other words, the proportion has the revenues reported in the financial statements of an entity, less the *defence revenues* of that entity in the numerator. It has the total revenues reported in the financial statements of the entity in the denominator. For an entity that does not derive any *defence revenues* (e.g. a *segment entity* of a *disclosed segment* that is not a *defence segment*), the proportion is 100%, meaning that there is no further adjustment beyond that required by Annex B Section 4.

2163. Subparagraph (j) defines the term “non-defence entity elimination profit (or loss)”. This term is relevant for calculating the elimination of double taxation obligations, which are performed on an entity and jurisdictional basis. This means the *non-defence entity financial accounting profit (or loss)*, then the adjustments required for the Elimination Profit (or Loss) are performed on a pro rata basis. The pro rata adjustment is in the same proportion as was used in calculating the *non-defence entity financial accounting profit (or loss)* (as applied in paragraph 3(k)). The proportion has the revenues reported in the financial statements of an entity, less the *defence revenues* of that entity in the numerator. It has the total revenues reported in the financial statements of the entity in the denominator. This has the effect that the calculation of the entity's profit (or loss) for the purpose of calculating the elimination obligations will only be with respect to the non-defence profit (or loss). For an entity that does not derive any *defence revenues* (e.g. a *segment entity* of a *disclosed segment* that is not a *defence segment*), the proportion is 100 per cent, meaning that there is no further adjustment beyond that required by Annex B Section 4(2).

2164. Subparagraph (k) defines the term “non-defence entity financial accounting profit (or loss)”. This term is relevant for calculating the elimination of double taxation obligations, which are performed on an entity and jurisdictional basis. It adjusts the Entity Financial Accounting Profit (or Loss) as would have been calculated under Annex B Section 4, by reducing it by a proportion. The proportion has the revenues reported in the financial statements of the Entity, minus the *defence revenues* of that Entity in the numerator. It has the total revenues reported in the financial statements of the Entity in the denominator. For an entity that does not derive any *defence revenues* (e.g. a *segment entity* of a *disclosed segment* that is not a *defence segment*), the proportion is 100 per cent, meaning that there is no further adjustment beyond that required by Annex B Section 4.

2165. Subparagraph (l) defines the term “non-defence entity payroll”. This term is relevant for calculating the elimination of double taxation obligations, which are performed on an entity and jurisdictional basis. It means the *entity payroll* that would otherwise be determined under Annex B Section 5(j) multiplied by the non-defence revenue as a proportion of total revenue calculated in paragraph 3(k)(i) and (ii). In other words, the proportion has the revenues reported in the financial statements of an entity, less the *defence revenues* of that entity in the numerator. It has the total revenues reported in the financial statements of the entity in the denominator. For an entity that does not derive any *defence revenues* (e.g. a *segment entity* of a *disclosed segment* that is not a *defence segment*), the proportion is 100 per cent, meaning that there is no further adjustment beyond that required by Annex B Section 4.

2166. Subparagraph (m) the term “non-defence taxable presence elimination profit (or loss)”. This term is relevant for calculating the elimination of double taxation obligations, which are performed on an entity and jurisdictional basis. It means the *non-defence entity financial accounting profit (or loss)* that is subject to the Taxable Presence, subject to adjustments in Annex B Section 4(2)(a) through (j), those adjustments being based on a proportion. The proportion is the same as used in subparagraph (k). For a Taxable Presence that does not derive any *defence revenues*, the proportion is 100 per cent, meaning that there is no further adjustment beyond that required by Annex B Section 4.

2167. Subparagraph (n) defines the term the “non-defence financial accounting profit (or loss)”. This term is relevant for identifying the *non-defence adjusted profit before tax*, which in turn is used for allocating the non-defence profits of the Group to the market. It provides two alternative approaches to calculate the Group’s *non-defence financial accounting profit (or loss)*: an approach relying on *disclosed segments* (subparagraph (n)(i)) and a group pro rata approach.

2168. The first approach relies on the *defence group’s disclosed segments*. It would apply if the Group elects to apply this approach, and where the *defence group* has two or more *disclosed segments*, at least one of which is a *defence segment* (discussed above), and at least one of which is not a *defence segment* (i.e. a segment for which none of the revenues reported in the segment and that are included in the Adjusted Revenues are *defence revenues*, such as a *disclosed segment* that only sells commercial aircraft). The approach starts with the Financial Accounting Profit (or Loss) of the Group and then makes two adjustments. First, it adjusts for *unallocated income*, *unallocated expense* and *corporate segment income or expense*, which is added to the *segment financial accounting profit (or loss)* of each *defence segment*. This is performed using the *allocation factor* (as set out in Annex C Section 4). From that adjusted figure, a deduction is made. This excludes a pro rata amount in respect of each *defence segment*. The amount excluded is the amount calculated under clause (A) of each *defence segment*, multiplied by a proportion. The proportion has the *defence revenues* reported in the *defence segment* to the extent those revenues are reported in the Consolidated Financial Statements for the Period in the numerator, and the *segment adjusted revenues* of the *defence segment* for the Period in the denominator. This approach means that the approach is a top-down approach, starting from the Group’s Financial Accounting Profit (or Loss), with the pro rata approach applying with respect to all *defence segments*, but otherwise relies on the profit as reported for all other segments (other than the usual adjustments required in the Convention).

2169. The group pro rata approach applies in all other cases (either where there are no *disclosed segments*, all of the *disclosed segments* are *defence segments*, or the group does not elect to use the approach in subparagraph (n)(i)). In this case, the *non-defence financial accounting profit (or loss)* means the Financial Accounting Profit (or Loss) of the *defence group* adjusted on a pro rata basis. The adjustment is calculated by multiplying the Financial Accounting Profit (or Loss) of the *defence group* by a proportion. The proportion has the *non-defence adjusted revenues* of the *defence group* for the Period in the numerator. It has the Adjusted Revenues of the *defence group* for the Period in the denominator. This is the same conceptual approach taken for determining the other adjustments in this paragraph (i.e. a pro rata adjustment by reference to revenues), but applies looking at the Group as a whole, rather than on an entity and jurisdictional basis.

2170. Subparagraph (o) defines the term “non-defence relevant net losses”. These are the losses to be carried forward and deducted in the calculation of the Covered Group’s *non-defence adjusted profit before tax* for a Period. The definition ensures that the calculation of *relevant net losses* for Groups that conduct defence activities only includes the appropriate losses (i.e. not the losses that relate to defence). *Non-defence relevant net losses* include the same two components as *relevant net losses* in the general rules under Annex B Section 2(3), except they are calculated with reference only to the appropriate losses. First, *non-defence relevant net losses* always include the *non-defence eligible net losses* (i.e. historical losses incurred within the Covered Group itself). Second, they can also include *transferred losses* (i.e. historic losses incurred by a separate business that has since been transferred to the Covered Group). Such *transferred losses* are calculated in accordance with the general rules in Annex B Section 2(3)(b) and (4) (including as they relate to the modalities of lodging the election), but with reference only to the appropriate (i.e. non-defence) losses of the *transferred group, entity or predecessor group*. This second part of the definition is only relevant if the Covered Group has made an election to recognise *transferred losses* in respect of a particular business combination or division. See the Explanatory Statement to Annex B Section 2(3)(b) for further detail. Note that losses that relate to defence are not carried forward. In the event that the defence business becomes profitable in the future, there is no need for using such previous losses, given that the profit relating to the defence business is excluded in any event.

2171. Subparagraph (p) defines the term “non-defence taxable presence depreciation”. It means the *taxable presence depreciation* reduced in proportion to reflect only the non-defence revenues of the taxable presence. The proportion is the non-defence revenues of the Taxable Presence divided by the total revenues of the Taxable Presence.

2172. Subparagraph (q) defines the term “non-defence taxable presence payroll”. It means the *taxable presence payroll* reduced in proportion to reflect only the non-defence revenues of the Taxable Presence. The proportion is the non-defence revenues of the Taxable Presence divided by the total revenues of the Taxable Presence.

2173. Subparagraph (r) defines the term “non-defence unused loss”. This definition follows that found in Annex B Section 2(5)(h), but provides that the loss is calculated by reference to the *non-defence financial accounting profit and loss* of a prior Period and therefore removes the profits and losses derived from defence activities.

2174. Subparagraph (s) defines the term “specified government body”. It has two elements, both of which must be satisfied. First, the nature of the body is that it is part of a government. This means that it includes any body, however designated, that constitutes a governing authority of a jurisdiction. A *specified government body* therefore does not include a non-state paramilitary organisation such as an armed political organisation, an organisation providing private security to citizens, or a contractor engaged by a government. The second element is that it is legally constituted for the purpose of providing defence or intelligence services. That would include a department of defence, a national military force, an international

peace-keeping agency, a national intelligence agency or supranational intelligence agency, and a space agency that has a responsibility for military or intelligence services for purposes of national or international defence. The final part of the definition provides that it does not include domestic law enforcement agencies, such as a civil police force, customs agency or fire service.

Paragraph 4

2175. Paragraph 4 includes a de minimis rule. It provides that a Group is not a Covered Group in the Period if the *non-defence adjusted profit before tax* for the Period of the Group is less than 10 per cent of the Adjusted Profit Before Tax of the Group for the Period.

2176. This paragraph recognises that where non-defence portion of the Group is below this amount, the administrative burden associated with applying the administrative rules may be excessive and disproportionate compared to the benefit of applying Amount A, and therefore justify an exclusion of the Group from the scope of the Convention.

Paragraph 5

2177. Paragraph 5 replaces the term "relevant net losses" with the term "non-defence relevant net losses". This replacement term applies to a Group that is not a *defence group* in the current Period, but was a *defence group* in a prior Period. This is necessary to ensure that the correct calculations are applied in the current Period, where they would be affected by the historical application of the rules for a *defence group* for the prior Period.

2178. The effect of Section 5 is that the defence losses incurred in the prior Period cannot be used to offset against Amount A in the current Period.

Paragraph 6

2179. Paragraph 6 provides that the Conference of the Parties may settle the mode of application of the provisions of the defence adjustment in Annex C Section 6. This may include further guidance on the information a Group would be required to produce to demonstrate it has met the definition of *defence purpose* or *defence revenues*. Such guidance could include a requirement for certification of the nature and amount of *defence revenues* by or on behalf of a *specified government body*, and guidance including in cases of dual use supplies and items that are component parts where the user, but not the immediate procuring party, is a *specified government body*.

Annex D – Supplementary provisions for Articles 6 and 7

2180. Annex D provides additional detail with respect to each category of Adjusted Revenues identified in Article 7. That detail consists of two things: the enumerated indicators; and the relevant *allocation key* (if applicable).

2181. However, those details are not the totality of how Adjusted Revenues may be sourced. In particular, the inclusion of the enumerated indicators in Annex D does not detract from the fact that Article 6 also permits a wider type of indicators that are not expressly included. These are referred to in this Explanatory Statement as another *reliable indicator*, and an alternative *reliable indicator* (see discussion on definition of *reliable indicator* above).

2182. In the case of government grants and non-customer revenues, there are no enumerated indicators nor specific *allocation key* that are provided. The detail for these categories is contained in full in Article 7. For that reason, there is no further discussion of those two categories in this Explanatory Statement to Annex D. The discussion of digital content as referred to in Article 7(1)(b) is contained in the discussion of other services contained in Annex D Section 3(F).

Section 1 – Finished goods

Paragraph 1

Overview

2183. Article 7(1)(a) and Annex D Section 1 provide revenue sourcing rules for finished goods. Finished goods means any tangible product sold to a final customer. It includes the sale of goods that may be acquired by purchasers as capital assets, such as machinery, but does not include digital content, components, services, *intangible property* or *immovable property*.

2184. Customer means a person who acquires goods or services from the Covered Group in the ordinary course of trade of the Covered Group and final customer means a person acquiring the finished good for consumption or use, other than as a component. The person acquiring the finished good can be a business customer. A business customer includes a government and means a person who acquires goods or services in a capacity other than as a consumer (which means an individual who acquires goods or services for personal purposes, rather than for commercial or professional purposes). Therefore the term customer includes sales made to a business or to an individual consumer, provided that the purchaser is acquiring the good for its own consumption, and not for resale (which would be the case of an independent distributor, as discussed below under this section) or incorporation into another product for resale (which would be the case of a component, as discussed below under Section 2). This also includes a business final customer using the goods in its industrial process.

Box 37. Examples – Definition finished goods

The following examples illustrate the application of the definition of finished goods.

Example 1

A sale of paper to a business for staff to use the printer is a sale of a finished good; whereas a sale of paper to a media company on which they print the newspapers and sell them is a component.

Example 2

Industrial gases, such as oxygen, nitrogen, carbon dioxide, which are manufactured through the transformation of other resources (e.g. air, natural gas) and sold to industrial customers (e.g. to manufacturers to facilitate production processes and oxygen to hospitals) are considered to be finished goods, and not components.

Example 3

A Covered Group sells a newly manufactured train to a transportation company that will use the train to provide services to its customers. Parts of the train are left incomplete, for example, the transportation company will add its own seating, catering equipment and branding to the train. The train although not fully completed will not be incorporated into another good for resale (i.e. because the train is not for resale, but for use by the transportation customer in providing its services) and therefore the train is not a component. The transportation company is the final customer and the train is a finished good.

Example 4

Manufacturing equipment used by the customer in its process to manufacture electronic chips is the sale of a finished good. The sale of the electronic chips by that (final) customer are the sale of components.

Example 5

A sale of a motor to a car manufacturer that assembles it in a car to sell is a component, whereas a sale of a motor to a taxi company that assembles it as a replacement part in one of its taxis is the sale of a finished good.

Example 6

Gasoline which is to be sold in a gas station for vehicles, or liquified natural gas (LNG) used as fuel for vehicles or ships, is a finished good, whereas oil that is used to produce plastic is a component.

Example 7

Extractive products, such as iron ore, aluminium, copper, metals, and diamonds, are elements that physically end up in a finished good in some form and therefore meet the definition of components (see also paragraph 2221 below). Thermal coal or LNG used for power generation would be an exception to this, because this element disappears in the production of electricity, which is a service and not a finished good. Therefore, as thermal coal or LNG used for power generation does not end up in a finished good, it is not a component, but a finished good.

Example 8

A Covered Group produces pills for a business customer under a manufacturing arrangement. The

business customer packs and sells the pills under their own name. As the pills do not need to undergo any further process other than packing, they are finished goods. The business customer acts as an independent distributor, and therefore, these are finished goods sold through an independent distributor.

Sourcing rule

2185. Article 7(1)(a) sets out the general revenue sourcing rule, which is the Jurisdiction in which the finished goods are delivered to the final customer.

2186. Annex D Section 1 sets out the more detailed rules for (i) sales of finished goods directly to a final customer and (ii) sales of finished goods through an independent distributor.

Paragraph 2

Sales of finished goods directly to a final customer

2187. Annex D Section 1(2) relates to the sale of finished goods directly to a final customer by a Covered Group. This would be the case, for example, where the Covered Group has its own retail outlet selling its products directly to customers, or is selling to its customers on its own website.

Indicators

2188. Paragraph 2 sets out the enumerated indicators that could be used, which include the customer's delivery address or the location of the retail store selling to the final customer, as relevant to the business model.

Box 38. Examples – Indicators for the sale of finished goods directly to a final customer

The following examples illustrate the use of indicators to source Adjusted Revenues from the sale of finished goods sold to final customers directly by a Covered Group.

Example 1

A Covered Group manufactures and sells laptops. Customers can buy the goods online directly from the Covered Group using the Covered Group's website. As part of the buying process, customers include their delivery address for the laptops purchased. Those addresses may be used as indicators to source the Adjusted Revenues from the laptops sold through the Covered Group's website.

Example 2

The Covered Group in example 1 also operates retail stores in large cities in Jurisdiction A, Jurisdiction B and Jurisdiction C. The location of those retail stores may be used as indicators to source the Adjusted Revenues from the laptops sold by the Covered Group in each of those stores.

2189. As per the definition of *reliable indicator* in Article 6, another *reliable indicator* or an alternative *reliable indicator* could be used, if there is another type of information that demonstrates the Jurisdiction of delivery to the final customer.

Paragraph 3

Sale of finished goods through an independent distributor

2190. Annex D Section 1(3) relates to Adjusted Revenues from the sale of finished goods sold through an independent distributor. Independent distributor means an enterprise or other person that is not a Group Entity of the Covered Group that distributes or resells the Covered Group's finished goods. This rule would apply, for example, where the Covered Group sells its products to an unrelated retailer (such as a supermarket or department store) or has a distribution arrangement with an unrelated distributor. It also applies where another person, such as an *international organisation* or a charitable group, is selling or providing the finished goods to other persons, whether for a price or as a donation. The Adjusted Revenues that are sourced here are the Adjusted Revenues that the Covered Group has earned from the independent distributor, and not the Adjusted Revenues that the independent distributor is in turn earning from selling the goods (with a mark-up) to its customers.

2191. As the Covered Group does not transact directly with the final customer, but the sale is made through an intermediary, revenue sourcing can be more challenging, and additional rules are contained in paragraph 3 to provide alternative reasonable methods of identifying the source Jurisdiction. These rules are drafted in order of their priority of application – starting with indicators, to proxies, and finally to *allocation keys*.

Indicators

2192. Paragraph 3(a) sets out the enumerated indicators that could be used.

2193. Paragraph 3(a)(i) provides that this includes information reported by the independent distributor on the place of the delivery, based on the enumerated indicators included in paragraph 2 which are the delivery address of the final customer or the place of the retail store.

2194. Paragraph 3(a)(ii) provides that the indicator could also be the location of the independent distributor itself as a proxy for the place of final delivery. The location is the place where that business has its physical premises from where it operates. It is designed to identify the place where the independent distributor is usually located.

2195. This rule applies in two scenarios.

2196. The first is that the independent distributor is contractually restricted to selling in that location. For example, if the contract limits the independent distributor to sell only in Jurisdiction A, then all of the Adjusted Revenues earned through that distribution arrangement would be sourced to Jurisdiction A. This is the case even if the independent distributor breached that contract and in fact sold the products in Jurisdiction B.

2197. The second case when the location of the independent distributor can be used as a proxy for the place of final delivery is that, even in the absence of a contractual restriction, it is otherwise reasonable to conclude that the independent distributor is located in the same place as the place of the delivery of the finished goods to the final customer. "Reasonable to conclude" does not require that the Covered Group has actual knowledge amounting to conclusive proof of the fact; but it means that based on the relevant facts and circumstances, it is more likely than not that the location of the independent distributor is the

same as the location of the final customers. “Reasonable to conclude” requires more than a mere assertion; it involves an objective analysis of the relevant facts and circumstances and weighing that evidence to determine whether it is more likely than not that the location of the independent distributor is the same as the location of the final customers. If a Covered Group determined, based on an objective analysis of the relevant facts and circumstances, that it was more likely than not that in 45 per cent of cases the Jurisdiction of delivery to the final customers of finished goods sold through an independent distributor was the location of the independent distributor, then the location of the independent distributor may be used as a *reliable indicator* for 45 per cent of those Adjusted Revenues.

2198. The “reasonable to conclude” condition means that information other than formal legal requirements (whether in contracts or national laws) can be used, including inferences based on the design, marketing and placement of the goods; intelligence from commercial practice; and market research information prepared for internal strategic and marketing purposes.

Box 39. Examples – “Reasonable to conclude” condition for the sale of finished goods through an independent distributor

The following examples illustrate the principles of the “reasonable to conclude” condition.

Example 1

The goods have a very high freight cost and/or are highly fragile or perishable. This means that it is not commercially viable to transport them for long distances and the only way to organise the distribution is to have production close to the final distribution. The production and distribution take place in Jurisdiction A which is geographically isolated. The production and distribution also takes place in Jurisdiction B, which is a large Jurisdiction. In both cases, taking account of the facts and circumstances (the perishable nature of the goods, the geographic position of Jurisdiction A and the size of Jurisdiction B), it is more likely than not that the goods are not transported beyond the national borders of Jurisdiction A or B. It is therefore reasonable to conclude that the finished goods are delivered to final customers in Jurisdiction A and Jurisdiction B, and the Adjusted Revenues from this independent distributor are sourced to Jurisdiction A and B in proportion to the Adjusted Revenues earned from each Jurisdiction.

Example 2

The independent distributor is located in Jurisdiction C, and the products have packaging that is specific to Jurisdiction C, including packaging labelling and instructions in the language of Jurisdiction C. No other Jurisdictions speak this language. Taking account of the facts and circumstances, it is reasonable to conclude the goods are sold in Jurisdiction C, and the Adjusted Revenues from this independent distributor are sourced to Jurisdiction C.

Example 3

The independent distributor is located in Jurisdiction D, and the products have been designed specifically to meet the consumer preferences of Jurisdiction D. These preferences are very specific, reflecting the cultural, economic or religious factors relevant to Jurisdiction D, and which make it unlikely that it would be commercially successful in any other Jurisdiction. Taking account of the facts and circumstances, it is reasonable to conclude the finished goods are delivered to final customers in

Jurisdiction D, and the Adjusted Revenues from this independent distributor are sourced to Jurisdiction D.

Example 4

The independent distributor is located Jurisdiction E, which is a geographically isolated Jurisdiction, and does not have a presence in any other Jurisdiction. Taking account of the facts and circumstances, it is reasonable to conclude the finished goods are delivered to final customers in Jurisdiction E, and the Adjusted Revenues from this independent distributor are sourced to Jurisdiction E.

Example 5

The independent distributor is located in Jurisdiction F. The independent distributor is an independent family run retailer that is a very small business, based on the volume of goods distributed and the size of the premises. Based on the facts and circumstances it is reasonable to conclude the goods are delivered to final customers in Jurisdiction F, and the Adjusted Revenues from this independent distributor are sourced to Jurisdiction F.

Example 6

Pharmaceutical goods are sold by the independent distributor to a government or hospital in Jurisdiction G, which the government or hospital will supply to its residents through its health care system. Based on the facts and circumstances, it is reasonable to conclude the goods are delivered to final customers in Jurisdiction G, and the Adjusted Revenues from this independent distributor are sourced to Jurisdiction G.

Example 7

The Covered Group has appointed an independent distributor located in Jurisdiction K. The packaging, labelling and instructions are in the language of Jurisdiction K. The only other Jurisdiction that speaks that language is Jurisdiction L, a smaller Jurisdiction, which borders Jurisdiction K. No independent distributor has been appointed in Jurisdiction L and the Covered Group has no physical presence there. However, the Covered Group notes that 20 per cent of warranty registrations are made by final customers in Jurisdiction L. Based on the facts and circumstances, it is not reasonable to conclude that all of the finished goods are sold in the location of the independent distributor, Jurisdiction K. .

Example 8

The Covered Groups sells finished goods to an independent distributor located in Jurisdiction M. The products have packaging, labelling and instructions in the languages of Jurisdictions M, N, O and P. No independent distributors have been appointed in Jurisdictions N, O or P and the Covered Group has no physical presence in those Jurisdictions. It would not be reasonable to conclude that all of the finished goods are sold in the location of the independent distributor, Jurisdiction M.

Example 9

The Covered Groups sells finished goods to an independent distributor located in Jurisdiction Q. Jurisdiction Q is not geographically connected with nearby Jurisdictions R, S and T (all Jurisdictions are islands) but the sea legs between the Jurisdictions are relatively short and frequently operated. The finished goods can be easily transported by sea or air. The finished goods have instructions in the languages of Jurisdictions Q, R, S and T. No independent distributors have been appointed in Jurisdictions R, S or T and the Covered Group has no physical presence in any of those Jurisdictions.

Taking into account of the facts and circumstances it would not be reasonable to conclude that all of the finished goods are sold in the location of the independent distributor, Jurisdiction Q.

2199. As per the definition of *reliable method* in Article 6, another *reliable indicator* could be used.

Box 40. Examples – Another reliable indicator for the sale of finished goods through an independent distributor

The following examples illustrate the principles of another *reliable indicator* in the context of sales through an independent distributor.

Example 1

The Covered Group sells pharmaceutical products. It has access to an independent third-party database on the place of the final sale of those pharmaceutical goods. These databases are prepared by a reputable third party which has collected and provided the information. The databases are considered as reliable, as demonstrated by the fact that they are relied on by a range of pharmaceutical Covered Groups for commercial purposes (e.g. to manage product recall obligations) and by government regulators. The database is not public, but the Covered Group provides sufficient detail to tax authorities to demonstrate that information was accurately used for sourcing purposes (e.g. by providing a date-stamped extract of relevant data). Because this information demonstrates the source of the finished goods (by showing the destination of the final sale), and because it is based on information relied upon by the Covered Group for commercial purposes, it can be treated as another *reliable indicator* under Article 6.

Example 2

The Covered Group sells high-end consumer products, on which it offers a long-term warranty. The Covered Group has information on the beneficiaries of the warranty (i.e. the final customer) which provides a very high degree of coverage of all sales. This is because, for example:

- Given the nature of the product (i.e. that it is expensive and difficult to replace or repair without going through the Covered Group), the vast majority of consumers do register the warranty at the time of sale, or shortly thereafter. This has been tested through expansive market research and after-sales support which includes registering warranties where it was not done at the point of sale; or
- The warranty is registered at the point of sale, as a routine part of the sales function. The sale cannot be concluded without registering the warranty.

The Covered Group uses the warranty data as another *reliable indicator*. This information demonstrates the source of the finished good, is based on information used for another commercial purpose and can therefore be another *reliable indicator* under Article 6.

2200. In addition, as per the definition of *reliable method* in Article 6, an alternative *reliable indicator* could be used.

Box 41. Example – Alternative *reliable indicator* for finished goods sold through an independent distributor

The following example illustrates the principles of alternative *reliable indicator* in the context of sales through an independent distributor.

The Covered Group has used a combination of indicators, reliance on the location of the independent distributors, regional sales and statistical sampling to arrive at an approach to model of the Jurisdiction of delivery of its finished goods to final customers. This is as follows:

- The Covered Group has undertaken a review of a selection of its distribution contracts, using a statistically valid sample size.
- Of this pool, 80 per cent of its sales are made in the same location of the independent distributor. 15 per cent are known by the Covered Group to be sold in other Jurisdictions. The location of these other markets is known precisely in two thirds of these cases because there is export data available to demonstrate this (i.e. because the Distributor has a regional distribution arrangement, and the commercial arrangement is that the Covered Group exports the goods directly to the other Jurisdictions that form the regional territory without first shipping to the independent distributor's place of residence). In the other one third of these cases, the contract has a regional territory but the Covered Group does not know the precise proportions of sales made in each of these Jurisdictions. It estimates these using the *regional allocation key*.
- It extrapolates this information for the rest of its sales through independent distributors. This shows that under the terms of the legal arrangements the independent distributors are permitted to make their sales in Jurisdictions A to P.
- However, the Covered Group is aware that its goods are finally sold in Jurisdictions Q to Z, even though this is in breach of many contractual arrangements it has with its independent distributors. While it is not responsible for sourcing to Jurisdictions where sales are in breach of contractual arrangements, the Covered Group has chosen to model these likely export locations. This modelling has been done based on economists' assumptions taking into account the logistical costs of shipping each family product group of the goods relative to the gross margins associated with that family product group of goods. This shows that 10 per cent of the goods are likely to have ended up in Jurisdictions Q to Z. The proportion of sales made in those Jurisdictions are then allocated using the *regional allocation key*.

However, where this produced any statistically anomalous results (such as a very high return to Jurisdiction Q or a very low return to Jurisdiction Z relative to the average sales of the Covered Group in that region), the Covered Group further refines the approach by capping the return at (in the case of Jurisdiction Q) and increasing the return to (in the case of Jurisdiction Z) the statistical median for the immediately neighbouring Jurisdictions.

The Covered Group applies for *advance certainty* to use this approach as an alternative *reliable indicator* under Article 6. As such the Covered Group would need to explain the reasons for using this approach rather than using the indicators enumerated in Annex D as required by Article 6(b)(ii)(A). The Covered Group would also need to demonstrate that the approach produced results that were consistent with the sourcing rule as required by Article 6(b) and was otherwise reliable as required by

Article 6(b)(ii). In this respect the Covered Group:

- would be required to demonstrate that the sample size was statistically valid;
- would be expected to explain why it was reasonable to conclude that 80 per cent of the sales were delivered to final customers in the same locations as the independent distributors;
- should be able to rely on the export data as information that is otherwise reliable;
- should be able to treat allocations based on the *regional allocation key* as otherwise reliable;
- would be expected to explain the rationale for making adjustments to statistically anomalous results.

Allocation key: Identified region

2201. Annex D Section 1(3)(b) sets out two alternatives to the extent that no *reliable indicators* were used.

2202. Paragraph 3(b)(i) sets out the first alternative where the Covered Group knows, on the basis of legal or commercial factors, that its sales are made to an *identified region*. An *identified region* is any group of specific Jurisdictions, normally but not necessarily in a specific geographic location. Where the *identified region* is not defined by geographical boundaries, the Covered Group would need to demonstrate why the particular Jurisdictions formed an *identified region*. This rule is relevant to the extent that there are no *reliable indicators*, and to the extent that it cannot rely on the location of the independent distributor to source the finished goods. This may be the case, for example, where sales are made through an independent distributor which is not contractually restricted to one Jurisdiction but may have a specific territorial area in which it is authorised to sell and it does not provide reporting to the Covered Group on the proportions of final sales made. It may also be the case where the independent distributor does not have any territorial restriction, but where the Covered Group can otherwise demonstrate based on commercial or other information that the finished goods have been sold in a particular *identified region*.

Box 42. Examples – Identifying a region for the sale of finished goods through an independent distributor

The following examples illustrate the principles of allocation to an *identified region* in the context of sales through an independent distributor.

Example 1

As there can be no contractual restriction to sell only in specific Jurisdictions given the free movement of goods within the EU single market (which include EU Member States, members of the European Economic Area and Jurisdictions that are closely linked to the EU market through bilateral agreements), the independent distributor can only be contractually restricted to selling within the EU single market (and not to a specific group of Jurisdictions within the EU single market). Given that the Covered Group knows all of the possible Jurisdictions in which the goods can be sold, but does not know in what

proportions in each Jurisdiction, it should use the *regional allocation key*.

Example 2

The independent distributor does not have any contractual restriction as to where it may sell the Covered Group's goods. The Covered Group demonstrates that based on commercial factors, the independent distributor would only be selling in a specific region, comprising Jurisdictions A, B and C. This is because the products have packaging labelling and instructions that are widely spoken in Jurisdictions A, B and C but not in any other Jurisdiction. This enables the Covered Group to demonstrate that the goods are sold in Jurisdictions A, B and C only and the Adjusted Revenues from this independent distributor are sourced using the *regional allocation key*.

Example 3

The independent distributor does not have any contractual restriction as to where it may sell the Covered Group's goods. The Covered Group demonstrates that based on commercial technological factors, the independent distributor would only be selling in a specific region, comprising Jurisdictions D, E and F. This is because the products have electric plugs which have been designed specifically to meet the consumer requirements in this group of Jurisdictions and can only be used in Jurisdictions D, E and F. This enables the Covered Group to demonstrate that the goods are sold in Jurisdictions D, E and F, and the Adjusted Revenues from this independent distributor are sourced using the *regional allocation key*.

Example 4

The independent distributor does not have any contractual restriction as to where it may sell the Covered Group's goods. The Covered Group demonstrates that based on commercial factors, the independent distributor would only be selling in a specific region, comprising Jurisdictions G, H and I. This is because extensive internal and external market research conducted over several years shows that the products are aimed at a broader region comprising Jurisdictions G, H, I, J and K, but the particular products are only successful in Jurisdictions G, H and I. This is because there is little competition from any similar products, and the products are priced at a premium pricing point. In neighbouring Jurisdictions J and K, the products have a very small market share because of economic factors and market competition, and because customers in those other Jurisdictions are unwilling to pay a premium for the product. Market research information is used by the Covered Group to design its marketing strategy and to inform its management decisions as to where to establish its own presence. Although the Covered Group cannot demonstrate that the goods are not also sold in other Jurisdictions, it can show that at least 95 per cent of its Adjusted Revenues from these products are derived from Jurisdictions G, H and I. The Covered Group sources 95 per cent of its Adjusted Revenues from this independent distributor using the *regional allocation key*, allocating to Jurisdictions G, H and I.

Example 5

The independent distributor does not have any contractual restriction as to where it may sell the Covered Group's goods. However, the Covered Group can demonstrate based on economic modelling of the cost of transporting the goods, and the independent distributor's likely profit margins on those goods (given the competition in the market for the relevant goods and the limited range of prices the independent distributor could sell for), it would not be commercially feasible for the independent distributor to be transporting the goods beyond a certain distance. On the basis of this commercial information, the Jurisdictions within that distance form a region, and the *regional allocation key* is used to source the Adjusted Revenues from this independent distributor.

Example 6

Finished goods are sold to a non-governmental organisation (such as a charity or supranational agency) that distributes the goods for humanitarian aid purposes. It has a mandate and strategy focussing on developing countries. In the absence of knowledge as to the specific Jurisdictions in which the organisation is distributing the finished goods, it would be reasonable to allocate using the *regional allocation key*, defining the Jurisdictions that comprise the region based on their classification as Lower Income Jurisdictions.

Example 7

The Covered Group has appointed one independent distributor in each major region. The independent distributors do not have any contractual restriction as to where it may sell the Covered Group's finished goods. The Covered Group provides marketing and product information to each independent distributor that is specific to the region in which that distributor is located. The Covered Group receives aggregated reporting from the independent distributors as to the results and performance of the products, which includes information on the Jurisdictions in which the independent distributor is focussing. This shows that the independent distributors are focussing on the region for which they are appointed, and are not competing with each other by selling outside that region. Provided that the Covered Group can demonstrate the definition of each region, it can use the *regional allocation key*.

2203. Where the rule in paragraph 3(b)(i) applies, the remaining Adjusted Revenues are sourced using the *regional allocation key*, which is a defined term. As the *regional allocation key* is an *allocation key* within the meaning of Article 6(3)(c), the prerequisites for it to be a *reliable method* in accordance with Article 6(3)(a)(iv) are that the use of the *allocation key* is expressly permitted in the rule (which is the case for this rule); that the Covered Group demonstrates that it has taken reasonable steps to identify an enumerated indicator and concluded that no such *reliable indicator* is available; and that the knock-out rule is applied. The latter two are discussed in turn.

Box 43. Examples – Reasonable steps in the context of finished goods

The following examples illustrate the meaning of reasonable steps in the context of finished goods.

Example 1

The Covered Group holds an annual strategy and performance meeting with each of its independent distributors. At this meeting, it asks for information from the independent distributor on the list of Jurisdictions served by the independent distributor. However, it does not ask for the proportionate breakdown of sales in each Jurisdiction as in this case the Covered Group knows that asking for such information would create commercial disruption and competitiveness issues (and can explain the reasons for this), and would thus be beyond the requirements of reasonable steps.

Example 2

The Covered Group conducts market research, focussing on the Jurisdictions in which it does not have any sourcing results through enumerated *reliable indicators*, including the location of the distributor. This includes engaging persons to conduct sampling of the presence of products in a representative range of stores. With this, the Covered Group is able to collect additional information (and then applies the rules relating to another *reliable indicator* to attempt to use this information), and its efforts amount

to taking reasonable steps.

Example 3

The Covered Group sells fast moving consumer goods. In all cases sales are made through a vast network of independent distributors. It uses *reliable indicators* and the location of the distributors in appropriate cases. However, the remaining portion of its finished goods sales (representing 10 per cent of all finished goods sales) are made relatively evenly through thousands of independent distributors. It would be disproportionately burdensome for the Covered Group to request information from each of those independent distributors about the Jurisdiction of delivery of the finished goods sold and would be beyond the requirements of reasonable steps.

Example 4

The Covered Group manufactures pills exclusively for one business customer, which packages and sells the products to its final customers. The business customer is an independent distributor of the Covered Group, however, for competitiveness reasons, the business customer does not share information on the proportionate breakdown of its sales. It would be beyond the requirements of reasonable steps for the Covered Group to ask its customer for this information.

2204. The *regional allocation key* will only be considered a *reliable method* provided that the knock-out rule is applied. However, as noted in the discussion on the Article 6(3)(a)(iv), the knock-out rule is treated as automatically satisfied in the context of the *regional allocation key*, by virtue of the identification of the *identified region*. It is only that portion of Adjusted Revenues that could then be sourced under the *regional allocation key*, and only to the extent the Covered Group can demonstrate that the finished goods are sold in the *identified region*.

2205. The application of the *regional allocation key* means that the portion of Adjusted Revenues from finished goods that were sold in the *identified region* is sourced in full to the Jurisdictions in the region. It is sourced in proportion to the relative shares of *final consumption expenditure* of each Jurisdiction in that *identified region*.

Box 44. Example – Regional allocation key

An example of how the *regional allocation key* applies is as follows.

The Covered Group sells to an independent distributor which is contractually restricted to selling to Jurisdictions A, B and C in South East Asia. It earned EUR 100 through this distribution arrangement. The respective shares of *final consumption expenditure* are:

- Jurisdiction A: 8 per cent
- Jurisdiction B: 2 per cent
- Jurisdiction C: 10 per cent

Revenues are sourced as follows:

- Jurisdiction A: $(8 / 20) \times 100 = 40$
- Jurisdiction B: $(2 / 20) \times 100 = 10$

Allocation keys: Tail-end revenues

2206. Paragraph 3(b)(ii) applies where the Covered Group is unable to trace the Jurisdiction of delivery to the final customer using indicators under paragraph 2, and to the extent the *regional allocation key* under paragraph 3(b)(i) does not apply. This remaining portion of Adjusted Revenues is referred to as the “tail-end revenues”.

2207. Paragraph 3(b)(ii)(a) provides a rule that sources the tail-end revenues first using the *lower income jurisdiction allocation key* up to a value of 5 per cent of the total Adjusted Revenues derived by the Covered Group from the sale of finished goods through an independent distributor for that Period. If the 5 per cent threshold is not exceeded on an aggregated basis, all of the tail-end revenues are sourced using the *lower income jurisdiction allocation key* unless paragraph 3(b)(ii)(b) applies. If the 5 per cent threshold is exceeded on an aggregate basis, the 5 per cent limit is applied on a pro rata basis. Applying the limit on a pro rata basis means that 5 per cent of the Adjusted Revenues derived from each independent distributor that have not been sourced under paragraph 3(a) and (b)(i) are sourced using the *lower income jurisdiction allocation key* (unless paragraph 3(b)(ii)(b) applies) and the remainder of Adjusted Revenues derived from each independent distributor are sourced using the *excess tail-end revenues allocation key* provided for in paragraph 3(b)(ii)(c). This is further explained in the example under paragraph 2220 below.

2208. The *lower income jurisdiction allocation key* is a defined term, which means that the tail-end revenues are sourced to the Jurisdictions that meet the definition of Lower Income Jurisdictions. These are Jurisdictions that are defined by the World Bank as a Low-Income Economy or as a Lower-Middle Income Economy for the Period for which Adjusted Revenues are being sourced. Sourcing take place in proportion to the relative shares of *final consumption expenditure* of each Lower Income Jurisdiction.

2209. As the *lower income jurisdiction allocation key* is an *allocation key* within the meaning of Article 6(3)(c), the prerequisites for it to be a *reliable method* in accordance with Article 6(3)(a)(iv) are that the use of the *allocation key* is expressly permitted in the rule (which is the case for this rule); that the Covered Group demonstrates that it has taken reasonable steps to identify an enumerated indicator and concluded that no such *reliable indicator* is available; and that the knock-out rule is applied. The reasonable steps requirement is as above in respect of the *regional allocation key*.

2210. The knock-out rule makes provision for the case where the Covered Group does know that sales were not made in certain Lower Income Jurisdictions, even though it does not know positively in which Jurisdictions and in what proportions sales were actually made. This could be the case, for example, where the product is not permitted by regulators to be sold in certain Jurisdictions or where there are trade sanctions with respect to certain Jurisdictions, or where there are documented structural commercial impediments, such as where sales are suspended because of conflict or where a Covered Group has made a decision at board level not to sell into a particular Jurisdiction. This can be demonstrated by information available to the Covered Group from its own knowledge of legal or regulatory restrictions, or from information from the independent distributor.

2211. The knock-out rule is mandatory. This means that the Covered Group must consider whether it has knowledge of the fact that the place of delivery to the final customer of finished goods should not be

in certain Jurisdictions because of legal or regulatory or other documented structural commercial impediments, and, if so, must remove all such Jurisdictions from the allocation. This is not required to be done on a transactional level, but by looking at the business more systemically. In addition, the Covered Group is not required to apply the knock-out rule on a product level, but would do so on category level. The Covered Group must apply the same approach to the knock-out rule for all Jurisdictions. The approach taken and the results of the knock-out rule will be reported separately in the Convention documentation.

Box 45. Examples – Lower income jurisdiction allocation key

The following examples illustrate how the *lower income jurisdiction allocation key* applies.

Example 1

The Covered Group is selling to a number of independent distributors and has exhausted steps to use enumerated *reliable indicators*, and has applied the *regional allocation key* to the extent sales were made in specific regions.

For the year 2030, there is EUR 50 million remaining which cannot be sourced under the previous steps. In that year, 20 Jurisdictions meet the definition of a Lower Income Jurisdiction. 10 of these are located in Africa, eight in Asia and two in Central America. The Covered Group knows that the finished goods should not be sold in Central America, because of trade sanctions that would apply to the independent distributor. The two Jurisdictions in Central America are knocked-out.

EUR 50 million of tail-end revenues is allocated amongst the remaining 18 Lower Income Jurisdictions, in the same way as the example of the *regional allocation key* above.

Example 2

The Covered Group makes and sells electrical equipment which it sells through independent distributors. For the year 2030, there is EUR 5 million remaining which cannot be sourced under the previous steps. All of the finished goods made by the Covered Group have type G plugs and therefore are only suitable for use in countries with type G sockets. The Covered Group uses the information to knock out all Lower Income Jurisdictions that use other plugs and the Adjusted Revenues are split between the remaining Lower Income Jurisdictions using the *lower income jurisdiction allocation key*.

2212. Paragraph 3(b)(ii)(b) provides for cases when the Covered Group demonstrates that part or all of its tail-end revenues did not arise in any Lower Income Jurisdictions. In that case, the Covered Group sources that part of its tail-end revenues using the *global allocation key*. If the Covered Group can demonstrate that no tail-end revenues arose in any Lower Income Jurisdictions, all tail-end revenues would be sourced using the *global allocation key*.

2213. The *global allocation key* uses *final consumption expenditure* and allocates Adjusted Revenues by reference to that metric. *Final consumption expenditure* is macroeconomic information that is usually published by the United Nations. If *final consumption expenditure* is not published by the United Nations in respect of a Jurisdiction for any of the previous five calendar years, the equivalent metric published by the World Bank should be used. In cases where *final consumption expenditure* is not available for a Jurisdiction from either of those sources for any of the previous five calendar years, the definition provides that an approximation of *final consumption expenditure* for that Jurisdiction should be calculated. That

calculation is based on that Jurisdiction's *gross national income* or GDP (in that order and based on availability) and the simple average of the ratio of *final consumption expenditure* to *gross national income* or GDP for all Jurisdictions for which *final consumption expenditure* was available.

2214. In summary, if tail-end revenues do not exceed 5 per cent of the total Adjusted Revenues from finished goods sold through all independent distributors for the Period they are (i) sourced to Lower Income Jurisdictions using the *lower income jurisdiction allocation key*; or (ii) partly sourced to Lower Income Jurisdictions using the *lower income jurisdiction allocation key*, and partly sourced using the *global allocation key* if the Covered Group can demonstrate that part of those tail-end revenues did not arise in any Lower Income Jurisdictions; or (iii) fully sourced using the *global allocation key* if the Covered Group can demonstrate that none of the tail-end revenues arose in Lower Income Jurisdictions.

2215. Paragraph 3(b)(ii)(c) provides a sourcing rule for the tail-end revenues exceeding 5 per cent. The excess is drawn proportionally from all independent distributors for which the Covered Group has been unable to source (part of) the Adjusted Revenues. For the excess, the Covered Group should apply the *excess tail-end revenues allocation key* which is a "85/15 rule", meaning that 85 per cent of the excess is sourced using the location of the independent distributor (paragraph 3(b)(ii)(c)(1)) and the other 15 per cent is sourced using the *global allocation key* but excluding the Jurisdiction which is the location of the independent distributor (paragraph 3(b)(ii)(c)(2)). This rule applies separately to each contract or each independent distributor, as is illustrated in the example below.

2216. The location of the independent distributor is where it has its physical premises (whether an office, warehouse or otherwise) from where it conducts the activities associated with the distribution of finished goods. In the case that the independent distributor has premises in more than one Jurisdiction, the place where the finished goods are delivered to can be assumed to be the premises from which that independent distributor conducts its activities. If the finished goods are delivered to multiple places, the Adjusted Revenues are allocated to each location based on the relative value of the goods delivered.

2217. As the *excess tail-end revenues allocation key* is an *allocation key* within the meaning of Article 6(3)(c), the prerequisites for it to be a *reliable method* in accordance with Article 6(3)(a)(iv) are that the use of the *allocation key* is expressly permitted in the rule (which is the case for this rule); that the Covered Group demonstrates that it has taken reasonable steps to identify an enumerated indicator and concluded that no such *reliable indicator* is available; and that the knock-out rule is applied. The latter two are discussed in turn.

2218. Reasonable steps means proactive efforts to investigate the Jurisdiction of the delivery of the finished goods to the final customer. The Covered Group is expected to use information that is available to it and that can feasibly be used to identify the Jurisdiction of delivery to the final customer (for example "ship to" information where that accurately identifies the Jurisdiction of delivery to the final customer). It does not include requesting the independent distributor for a renegotiation of the contractual terms to obligate detailed reporting to the Covered Group. There may be genuine commercial reasons as to why no *reliable indicators* are available in the context of sales through an independent distributor and, provided the Covered Group has taken reasonable steps to identify enumerated indicators, there should be no negative inference from the use of the *allocation keys* permitted in the rule. There should also be no negative inference in respect of the Covered Group's other revenue sourcing outcomes for different categories, recognising that they will involve quite different fact patterns and availability of data.

2219. The knock-out rule provides for cases where the Covered Group knows that sales were not made in certain Jurisdictions that would otherwise be entitled to allocations using the *allocation key*, even though it does not know positively in which Jurisdictions and in what proportions sales were actually made. As set out above, this can be demonstrated by information available to the Covered Group from its own knowledge

of legal or regulatory restrictions or documented structural commercial impediments, or from information from the independent distributor. The knock-out rule is mandatory. However, because the Covered Group only applies the *excess tail-end revenues allocation key* when it has challenges reducing its tail-end revenues, it is recognised that it may be challenging to apply the knock-out rule.

2220. Paragraph 3(b)(ii)(d) applies when the Covered Group knows or has a reasonable basis to conclude that the finished goods are primarily delivered to final customers outside the Jurisdiction of the independent distributor. This could be the case, for example, when the location of the independent distributor is a warehouse that operates as a procurement hub. The rule confirms that in those circumstances the *global allocation key* applies. “Reasonable basis to conclude” does not require that the Covered Group has actual knowledge amounting to evidence of the fact; but it means that, based on an objective analysis of the relevant facts and circumstances and weighing that evidence, it is more likely than not that the finished goods sold through an independent distributor are primarily delivered to final customers outside the Jurisdiction of the location of the independent distributor.

Box 46. Examples – Tail-end revenues

The following examples illustrates how the rules for tail-end revenues applies.

Example 1

A Covered Group sells its finished goods through independent distributors. There is one independent distributor that sells the Covered Group’s product worldwide. The Covered Group knows that most of these products are sold in developing countries, but the independent distributor is not able to provide the Covered Group with information on the place of the final customer of the goods. The Adjusted Revenues from this specific independent distributor are 1.3 per cent of the total Adjusted Revenues from finished goods sold through all independent distributors for the Period. The Covered Group applies the *lower income jurisdiction allocation key* to these Adjusted Revenues.

Example 2

A Covered Group sells its finished goods through independent distributors. There are two large independent distributors (X and Y) through which the Covered Group sells, but for commercial reasons, the independent distributors do not provide the Covered Group with information on where the final customers are located. Both independent distributors have contracts that are not legally restricted to one Jurisdiction, and there are no other reasons to assume that they are selling only into the Jurisdiction in which they are located. In addition, the Covered Group does not know whether the independent distributors are selling in a specific group of Jurisdictions, and so it cannot apply the *regional allocation key*. The Covered Group has taken reasonable steps to source the Adjusted Revenues, but without result. The Covered Group’s total Adjusted Revenues from finished goods through all independent distributors for the Period are EUR 1,000. The Adjusted Revenues from independent distributors X are 45 and independent distributor Y are 15, which is in total EUR 60, and therefore, the tail-end revenues are 6 per cent. The Covered Group has knowledge that distributor X does not sell into Lower Income Jurisdictions K and L. The rules for tail-end revenues apply as follows:

The tail-end revenues up to the 5 per cent limit (EUR 50) are sourced to Lower Income Jurisdictions using the *lower income jurisdiction allocation key*, as follows:

- Independent distributor X represents 75 per cent of the tail-end revenues

- 75 per cent of EUR 50 is EUR 37.5, allocated to lower income jurisdictions excluding Jurisdictions K and L
 - Independent distributor Y represents 25 per cent of the tail-end revenues
 - 25 per cent of EUR 50 is EUR 12.5, allocated to lower income jurisdictions; then

The tail-end revenues exceeding the 5 per cent limit (EUR 10) are sourced as follows:

- Independent distributor X represents 75 per cent of the tail-end revenues
 - 75 per cent of EUR 10 is EUR 7.5, allocated as follows:
 - EUR 6.4 (85 per cent of EUR 7.5) is sourced to Jurisdiction X (being the location of the independent distributor)
 - EUR 1.1 (15 per cent of EUR 7.5) is sourced to all other Jurisdictions, excluding Jurisdiction X, using the *global allocation key*
 - Independent distributor Y represents 25 per cent of the tail-end revenues
 - 25 per cent of EUR 10 is EUR 2.5, allocated as follows:
 - As Jurisdiction Y is the procurement hub of independent distributor Y, EUR 2.5 is sourced to all Jurisdictions (including Jurisdiction Y), using the *global allocation key*

Section 2 – Components

Paragraph 1

Overview

2221. Article 7(1)(c) and Annex D Section 2 provide revenue sourcing rules for components. Article 7(1)(c) refers to the Adjusted Revenues derived from a component as those that are sold to a business customer and that is designed to be incorporated directly or indirectly into a finished good that will be for sale. Article 7(1)(b) also provides that certain digital content may be a component. The language in Article 7(1)(b) and (c) can be broken down into four elements, which are cumulative conditions:

- A component can be a tangible product (because it is necessarily incorporated into a physical good), or it can be digital content. This means that components are generally tangible in nature, and therefore mutually exclusive with the category of *intangible property*. In referring to digital content (the meaning of which is further explained from paragraph 2361), the category includes, for example, a computer program sold to a business customer that will be incorporated into another good for sale, such as software that is pre-loaded onto a laptop.

- That is sold to a business customer. This reflects the purpose of the component, which is to form part of another business' good or product. By definition, components are not sold to individual consumers (and see discussion on "dual use components" below).
- That is designed to be incorporated directly or indirectly into another good. This means that a component is not a good that is a standalone final item, but one which only functions as part of another good. The reference to indirectly incorporated into another good accounts for cases when there may be multiple stages in the production process before the component is ultimately incorporated into the finished good. This further means a component is not something where it is used as part of the supporting inputs that make a production process work, and that is used up and no longer exists once that production process is complete – rather it must endure somehow as an incorporated part of the good and which the final customer therefore ultimately takes possession or use of. It does not include inputs that are consumed and no longer exist in any form after the production process, such as electricity (which is defined as a service), or industrial gases used to facilitate the wider production process (which would be finished goods). Whether the item is separately recognisable in the original form once incorporated into the final good is not relevant to the analysis. For example, items such as chemical compounds, production materials such as cement, plastics and steel, and raw agricultural materials can be components, even though they may be transformed in the production process and not be capable of being removed from the final good, provided that they are in some form ultimately part of the good the final customer obtains. The enduring nature of the component is not undermined if it can be removed or replaced by the customer (for example, the fact that software installed on a laptop by the manufacturer can be uninstalled does not prevent it from being treated as a component, similarly, the fact that tyres on a car might be replaced does not prevent them from being regarded as having an enduring nature).
- That resulting good is for sale. This means that the purpose of the incorporation into that other good is for sale, and not as an element of an item that the business will use for itself, such as a replacement part. This also means that a component is not something which forms part of a good which is not for sale, but is used e.g. in providing a service. This concept is discussed in further detail below.

Box 47. Example – Definition of components

The following example illustrates the application of the definition of components.

The Covered Group manufactures semiconductors as a service for other companies, known as a foundry. The Covered Group does not design the semiconductors, but manufactures them according to the design provided by the customer. It transfers all of the rights to the physical semiconductors to the customer and therefore, the Adjusted Revenues of the Covered Group that performs the manufacturing are properly categorised as components.

2222. Generally, finished goods and components would be mutually exclusive. However, it is possible that an item could be sold as a finished good in certain contexts and as a component in others. These are referred to as "dual use components". For example, the definition of finished good includes replacement parts where they are sold to the final customer (e.g. a blade of an engine sold to an airline, a tyre sold to the owner of the car, a semiconductor sold to a technology company that maintains and repairs its own server). Whether a dual use component is sold as a component or as a finished good will depend on whether the item into which it is incorporated is intended for onward sale. A dual use component will be a

finished good when it is an element of an item that the purchasing business will use for itself, such as a replacement part. This also means that a component is not something which forms part of a good which is not for sale, but is used by the business e.g. in providing a service. Software may often be a dual use component. If it is intended to be installed on a laptop for sale, then it would be categorised as a component but if it was installed for use by purchasing the business customer itself, it would be in the nature of digital content.

2223. If the Covered Group is not able to distinguish the sales of dual use components (e.g. because they are not run as separate business units, and so the Covered Group has no visibility on the ultimate breakdown of sales based on the nature of the customer), then the Covered Group would determine the category based on the ordinary character of the *transactions*, by reference to the intention of the Covered Group (see discussion above at paragraph 244). On the other hand, if the *transactions* were different depending on the context, the categorisation must be applied separately (as discussed above in paragraph 233). For example, a Covered Group selling paper would have different categorisations when selling that paper to a newspaper (where the intent is to provide the paper as a component), as opposed to selling a packet of paper for home office use (where the intent is to provide a finished good to final customers).

2224. The architecture of the rule is as follows: first, it sets out the sourcing principle; second it sets out the starting point which is to seek to use *reliable indicators*; and third it provides a backstop *allocation key* in the event there are no *reliable indicators*.

Sourcing rule

2225. Article 7(1)(c) states the sourcing rule, which is the place of delivery to the final customer of the finished goods into which the component is incorporated. This means that the sourcing rule looks through to the end of the supply chain and the ultimate destination of the component in the hands of the final customer, rather than the intermediate Jurisdictions where the component is used, transformed or assembled in the manufacturing process.

2226. Annex D Section 2(1) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from components.

Paragraph 2

Indicators

2227. Annex D Section 2(2) sets out the indicators which could be used which include information reported to the Covered Group on the place of final delivery of the finished good into which the component is incorporated, based on the delivery address of the customers or the location of retail stores selling the finished goods, or information on the location of the independent distributor selling the finished good provided that specific conditions are met, which are also included in Section 1(3)(a)(ii) and described in paragraph 2194.

2228. As per the definition of *reliable indicator* in Article 6, another *reliable indicator* or an alternative *reliable indicator* could be used if there is another type of information that demonstrates the place of delivery to the final customer of the finished goods. Although the Covered Group may not be able to precisely trace the final delivery of each individual component that is incorporated into another business's finished goods, it may have other firm-level reliable information, that could also be combined with other public or market information, that on an aggregate basis demonstrates the places of final delivery for that type of component with a high degree of probability.

Box 48. Examples – Alternative reliable indicator for components

The following examples illustrate the principles of an alternative *reliable indicator* in the context of sales of components.

Example 1

The Covered Group derives EUR 40 billion in sales of components to a range of third parties. It does not receive information from its customers about the sales of the finished goods into which the components are incorporated. However, half of its sales are to two finished goods manufacturers: it sells EUR 5 billion of components to Multinational Enterprise (MNE) 1 in a Period and EUR 15 billion to MNE2 in a Period. Most of the finished goods manufactured by MNE1 and MNE2 incorporate the type of components sold by the Covered Group, and MNE1 and MNE2 are not engaged in other unrelated businesses that do not incorporate the components. Neither MNE1 nor MNE2 provides information about the place of delivery of the finished goods that incorporate the Covered Group's components. However, both MNE1 and MNE2 publish their financial statements and other information about their business annually and which includes a breakdown of the total sales made by each business regionally. This is as follows:

	Sales of finished goods by region Published by MNE1	Sales of finished goods by region Published by MNE 2
Region 1	20 per cent	80 per cent
Region 2	30 per cent	10 per cent
Region 3	50 per cent	10 per cent

The Covered Group allocates Adjusted Revenues from sales of components using a combination of that data and gross domestic product value to allocate the Adjusted Revenues from components sold to MNE1 and MNE2 (given that GDP is the corresponding macroeconomic proxy used as the *allocation key* in the context of components).

Region 1 (comprising Jurisdictions A, B, C and D)

Total region 1 Sales: $(20 \text{ per cent} \times 5 \text{ billion}) + (80 \text{ per cent} \times 15 \text{ billion}) = \text{EUR } 13 \text{ billion}$

GDP Jurisdiction A: 18 per cent => Allocation to Jurisdiction A: EUR 7.8 billion

GDP Jurisdiction B: 3 per cent => Allocation to Jurisdiction B: EUR 1.3 billion

GDP Jurisdiction C: 7.5 per cent => Allocation to Jurisdiction C: EUR 3.25 billion

GDP Jurisdiction D: 1.5 per cent => Allocation to Jurisdiction D: EUR 0.65 million

Region 2 (comprising Jurisdictions E and F)

Total region 2 Sales: $(30 \text{ per cent} \times 5 \text{ billion}) + (10 \text{ per cent} \times 15 \text{ billion}) = \text{EUR } 3 \text{ billion}$

GDP Jurisdiction E: 20 per cent => Allocation to Jurisdiction E: EUR 2.4 billion

GDP Jurisdiction F: 5 per cent => Allocation to Jurisdiction F: EUR 0.6 billion

Region 3 (comprising Jurisdictions G, H, and I)

Total region 1 Sales: (50 per cent x 5 billion) + (10 per cent x 15 billion) = EUR 4 billion

GDP Jurisdiction G: 5 per cent => Allocation to Jurisdiction G: EUR 2 billion

GDP Jurisdiction H: 3 per cent => Allocation to Jurisdiction H: EUR 1.2 billion

GDP Jurisdiction I: 2 per cent => Allocation to Jurisdiction I: EUR 0.8 billion

The Covered Group applies for *advance certainty* to use this as an alternative *reliable indicator* under Article 6(3)(b)(ii). It must explain why it was used in place of an indicator enumerated in Annex D. In order to demonstrate that the information included in the financial statements of MNE1 and MNE2 is otherwise reliable, the Covered Group must:

- explain its reasoning for relying on that information (i.e., given MNE1 and MNE2 are finished goods manufacturers it is reasonable to expect that the location of their sales reasonably reflects the sales of the finished goods into which the Covered Group's components are incorporated), and
- explain that Jurisdictions A to L are expected to provide sufficiently broad geographical coverage as those are the Jurisdictions where MNE1 and MNE2 sell the finished goods incorporating the Covered Group's components.

As the data is included in published and audited financial statements of MNE1 and MNE2, the Covered Group can assume that the data has been accurately and appropriately collected. The approach of the Covered Group is based on the assumption that the sales of the finished goods of MNE1 and MNE2 is a reasonable reflection of the markets where its components end up. In that respect the Covered Group should outline how it has established that most of the finished goods of MNE1 and MNE2 incorporate components of a type sold by the Covered Group.

This approach could not be used in respect of the sales of components to customers that are not themselves selling the finished goods (but are at an intermediate step in the production process), because their own reporting will not relate to the finished goods that ultimately incorporate the components.

Example 2

The Covered Group derives EUR 8 billion in sales of components to a range of third parties. It does not receive information from its customers about the sales of the finished goods into which the components are incorporated. However, for 65 per cent of those sales it has information on the types of finished goods into which the component is intended to be incorporated. In some cases, this is included in the contract with its customer and related commercial documentation. In other cases, the components are designed to be included in a particular type of finished good (e.g., higher processing capacity for semiconductors designed to be incorporated into servers).

The commercial documentation and nature of the semiconductors indicates that:

- 30 per cent of the semiconductors are sold to be incorporated into mobile products (phones and tablets);
- 20 per cent of its semiconductors are sold to be incorporated into computers; and
- 15 per cent of its semiconductors are sold to be incorporated into television and related accessories.

The Covered Group has access to global market research data, which is compiled by a third party or compiled from its own data, which provides information on the numbers of phones, tablets and televisions sold internationally on an annual basis.

The Covered Group applies for *advance certainty* to use this combined data from the commercial documentation indicating the breakdown of the use of semiconductors and the global market research data as an alternative *reliable indicator* under Article 6(3)(b)(ii) for 65 per cent of the Adjusted Revenues derived from components. The Covered Group must:

- explain how the data is consistent with the sourcing rule (i.e., that it identifies the Jurisdictions where the finished goods incorporating the semiconductors are delivered to final customers) as required by Article 6(3)(b);
- explain its reasoning for determining that those semiconductors are sold to be incorporated into the identified finished goods as required by Article 6(3)(b)(ii);
- explain why it considers the global market research data to be credible paying particular attention to any assumptions upon which the data is based as required by Article 6(3)(b)(ii);
- if using its own data as the source of the market research data, further explain the methodology used in compiling its own data and why it considers that data to be credible as required by Article 6(3)(b)(ii);
- explain why it did not use the indicators enumerated in Annex D as required by Article 6(3)(b)(ii); and
- explain why it considers the approach to be otherwise reliable as required by Article 6(3)(b)(ii).

Paragraph 3

Allocation key

2229. In the case of the sale of components, the Covered Group does not transact directly with the final customer, but the sale is made through an intermediary – and possibly is sold again and again at multiple points throughout a supply chain as the component is transformed to or assembled into the finished goods. It is expected that the Covered Group is in many cases unlikely to have *reliable indicators* on the place of delivery of the finished goods, and that the immediate business to which the component is sold is either unlikely to also know the final destination of the finished goods, or may be unwilling to divulge that information.

2230. As such, Annex D Section 2(3) provides a method for sourcing Adjusted Revenues that cannot be sourced under paragraph 1 (which may be all of the Adjusted Revenues from components). This is the *component allocation key*, which is a defined term.

2231. As the *component allocation key* is an *allocation key* within the meaning of Article 6(3)(c), the prerequisites for it to be a *reliable method* in accordance with Article 6(3)(a)(iii) are that the use of the *allocation key* is expressly permitted in the rule (which is the case for this rule); that the Covered Group demonstrates that it has taken reasonable steps to identify an enumerated indicator and concluded that no such *reliable indicator* is available; and that the knock-out rule is applied. The latter two are discussed in turn.

2232. Reasonable steps are included in the rule to ensure, insofar as practical, reliable information is obtained. For example, if a components Covered Group did obtain some reliable information on the final destination of its components, this should be used, even if it does not cover all sales. Likewise, if technological solutions that enable the tracing of components to the market Jurisdiction became commercially feasible solutions, this could be used to accurately source Adjusted Revenues from components. In that sense, the reasonable steps requirement future-proofs the rules as technology evolves and prevents over-reliance on the *component allocation key* to the extent possible.

2233. However, as noted above, it is expected to be challenging to accurately trace the sale of components to the final market. Therefore, the expectation of reasonable steps must be proportionate and should take account of the costs and likely benefits. The Covered Group is expected to use information that is available to it and that can feasibly be used to identify the Jurisdiction of delivery to the final customer of the finished good including the component. As such, a Covered Group selling components should discuss with the relevant operational and management team responsible for the component business whether any such reliable information was available to the business. That discussion should be in-depth and not merely perfunctory, and it should separately cover each relevant business line of the Covered Group (and as such may involve a series of discussions with each relevant business line). It would not require discussion of each individual component and whether or not it was possible to track where the related finished goods were delivered to the final customer but would be a broader discussion to understand whether any reliable information was available. The reasonable steps requirement would be fulfilled if, based on those discussions to the best of its knowledge it does not have in its possession any reliable information on the final destination of its components. It would not include renegotiating a contract with a customer, or including reporting from the customer in a future contract. While a Covered Group is not precluded from taking measures beyond the reasonable steps described, should it wish to do so, there can be no negative inference in respect of a Covered Group that met the reasonable steps requirement and then proceeded to use the *allocation key* in respect of any remaining Adjusted Revenues.

Box 49. Example – Reasonable steps in the context of components

The following example illustrates the meaning of “reasonable steps” in this context.

A Covered Group sells semiconductors to a phone manufacturer which then sells these phones to a finished goods MNE, which then distributes the phones through its own sales channels. The finished goods MNE is not the direct customer of the Covered Group. The Covered Group does not communicate or contract directly with the finished goods MNE. The Covered Group discusses the availability of information on the place of delivery to final customers of the phones into which the Covered Group’s components are incorporated with the relevant operational and management team responsible for the component business. The outcome of that discussion is that those persons confirm

that no such information is available. The Covered Group has satisfied the reasonable steps requirement.

2234. Before the application of the *component allocation key* can be considered a *reliable method*, the Covered Group must also apply the knock-out rule. This is the same concept as discussed above for the tail-end revenues from the sale of finished goods through an independent distributor. It also means that where the Covered Group can demonstrate that finished goods incorporating its components should not be sold in certain Jurisdictions, these are removed from the allocation, and no Adjusted Revenues are sourced in those Jurisdictions. It also means that where the Covered Group can demonstrate that finished goods incorporating its components are only sold in a sub-set of Jurisdictions but does not know the proportions of sales in each market, in which case it can “knock-out” all other Jurisdictions (which in effect makes the *component allocation key* (and other *allocation keys* that include the knock-out rule, such as the *global allocation key*) operate in the same way as the *regional allocation key* used for finished goods).

2235. The knock-out rule would apply in cases where there is an objective, structural reason based in law or regulation or other documented structural commercial impediment that the components were not or should not be sold in a Jurisdiction. Examples of how the knock-out rule could be applied in the context of components include where the Covered Group can demonstrate that its component such as a chemical ingredient, a material or a type of technology is not permitted to be used in certain Jurisdictions, or the component is integrated into a certain type of finished goods that is not legally authorised for sale in certain Jurisdictions. It could also be used where the component is designed such that it meets certain specifications required for a particular market, and which would not be suitable or economic to sell in other markets.

2236. However, because the components Covered Group is further removed from the sale of the finished goods to the final customer, it is acknowledged that it may be challenging to apply the knock-out rule. This may mean that the *component allocation key* applies to more than 100 Jurisdictions. In other words, the demands of the reasonable steps requirement for components are in line with the expectations of the knock-out rule, given that in this context no further information may come to light. Following the fulfilment of the requirements of the reasonable steps requirement, the Covered Group could also consider the application of the knock-out rule in that same discussion with the relevant operational and management team.

2237. The *component allocation key* means that the Adjusted Revenues from components are apportioned to all Jurisdictions in proportion to their respective shares of GDP.

2238. The allocation is performed in a similar way to the *regional allocation key* described above.

Box 50. Example – Application of component allocation key

An example of how the *component allocation key* applies is as follows.

The Covered Group sells components of a technological nature. It has taken reasonable steps to use a *reliable indicator* and no information is available. It has also applied the knock-out rule, and because of trade sanctions, it is not permitted to provide its components to any customer that would ultimately sell into Jurisdictions A, B and C. It has put in place measures to give effect to this, in the form of contractual terms with its customers.

It earned EUR 200 from the sale of components. The respective shares of GDP are:

- Jurisdiction D: 4 per cent
- Jurisdiction E: 0.5 per cent
- Jurisdiction F: 10 per cent
- [etc. for remaining Jurisdictions]

Adjusted Revenues are sourced as follows:

- Jurisdiction D: 4 per cent x 200 = 8
- Jurisdiction E: 0.5 per cent x 200 = 1
- Jurisdiction F: 10 per cent x 200 = 20
- [etc. for remaining Jurisdictions]

Section 3 – Services

Overview

2239. Article 7(1)(d) and Annex D Section 3 provide revenue sourcing rules for services. There are nine categories of services. In general terms, a service involves the provision of a benefit through the performance of an activity that uses items that generally are not transferred. This distinguishes it from the other categories, which do involve a transfer of a good, right, data or property. Separate rules are provided for each, in order to provide, to the extent possible, specific revenue sourcing rules that are tailored to the context and nature of the market for each type of service.

2240. If a service does not fit in any of the categories in Article 7(1)(d)(i) through (viii) inclusive, the general rules applying to other services in Article 7(1)(d)(ix) apply.

A – Location-specific services

2241. Article 7(1)(d)(i) and Annex D Section 3(A)(1) provide revenue sourcing rules for *location-specific services*.

2242. This category covers two types of services: services connected to tangible property and services performed in the presence of the customer, with a separate sourcing rule for each type of service. The term *location-specific service* is defined in Annex D Section 7. The same defined term of *location-specific services* is also used in respect of the online intermediation of *location-specific services*, discussed in Annex D Section 3(C). The definition of *location-specific service* has two parts, the first describes services connected to tangible property and the second describes services provided in the presence of the customer.

Overview

2243. A service connected to tangible property is a service that meets any one of five criteria:

- If substantially all of the service is performed at the location of the tangible property and the service results in the physical manipulation of that property, whether through building, demolition, maintenance or repair, the service will be a service connected to tangible property (e.g. repair services). Physical manipulation of property does not include any manufacturing activity. Revenue sourcing of manufacturing should be based on the type of product that was manufactured (see example 8 on the definition of finished goods above at paragraph 2184, and an example on the definition of components above at paragraph 2221).
- Any lease, hire of, or licence to use tangible property (e.g., car hire).
- The provision of utilities to a fixed premises (e.g. such as telecommunications, gas or electricity if provided to a fixed location, as opposed to utilities not provided to a fixed location and which are treated as other services), and for this purpose, the fixed premises is the relevant tangible property.
- Advisory services connected to *immovable property* (e.g. architectural and engineering services related to the development of a building, a bridge or other infrastructure, or legal services related to the sale or acquisition of real estate).
- Services that facilitate the arrival or departure of a ship or aircraft to a Jurisdiction (e.g. pilotage and towage services provided in and close to ports and port, airport and terminal services), and for this purpose the aircraft, ship or other vessel is the tangible property.

2244. While a service connected to tangible property extends to include leases of and licences to use *immovable property*, Adjusted Revenues from *immovable property* are sourced using the *immovable property* rule in Article 7(1)(g) and are expressly excluded from the application of Article 7(1)(d)(i).

2245. A service performed in the presence of the customer is a service that is physically performed in person where the customer or its agent must be present for substantially all of the time at the location where the service is performed. Services performed in the presence of the customer includes entertainment services such as concerts and live sporting events when the customer must be present in order to receive the benefit the service. It would also include medical services and restaurant services. The customer is not required to be present for all of the time that the service is performed but whether or not the customer is present does not have to be tested on a case-by-case basis. However, in order to fall within this definition, it should be the case that in order to enjoy the benefit of the service, the customer would need to be present for most of the time the service is performed. For example, in order to enjoy a concert, the customer must be present for the performance. The definition includes passenger transport services as the customer must be present where the service is performed. However, passenger transport services are sourced using the transport services rules in Article 7(1)(d)(vi) and are expressly excluded from the application of Article 7(1)(d)(i). The inclusion of the reference to the agent of the customer is designed to capture services provided to businesses that must be performed in the presence of the business's employee(s), such as in-person training provided by a consultancy business to the staff of a business customer where the staff must be physically present to receive the training.

Sourcing rule

2246. Article 7(1)(d)(i)(A) provides the sourcing principle, which is that Adjusted Revenues from services connected to tangible property are sourced to the Jurisdiction in which the property is located. Given the nature of the services identified, the service should generally be performed at the location of the tangible

property. If the nature of the tangible property is such that it is movable, and could be located in more than one Jurisdiction (for example, if a customer who leases a car could drive the car across a national border), the Covered Group should assume that the place the tangible property is delivered to the customer is the place where the tangible property is located throughout the period of performance.

2247. Paragraph 1 of Annex D Section 3(A) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from *location-specific services*.

Indicators

2248. Annex D Section 3(A)(2)(a) sets out the indicators which could be used for services connected to tangible property, notably the location of the tangible property when the service is performed, reflecting the nature of the services covered by this category of Adjusted Revenues. As per the definition of *reliable indicator* in Article 6, another *reliable indicator*, or an alternative *reliable indicator* could be used, if there is another type of information that can be used to identify the Jurisdiction in which the property is located.

2249. Annex D Section 3(A)(2)(b) sets out the indicators which could be used for services performed in the presence of the customer, where the customer (or its agent) is situated when the service is performed, reflecting the nature of the services covered by this category of Adjusted Revenues.

2250. As per the definition of *reliable indicator* in Article 6, another *reliable indicator*, or an alternative *reliable indicator* could be used, if there is another type of information that can be used to identify the place of performance.

2251. Annex D Section 3(A)(3) is included to deal with circumstances when the tangible property in respect of which the service is provided is located in international waters or international airspace when the service is performed. For this purpose international waters means waters other than internal waters, territorial seas and maritime areas over which a Jurisdiction has sovereign rights or jurisdiction for purposes of exploration, exploitation and preservation of natural resources, whether living or non-living, pursuant to international law. International airspace means airspace other than that above land territories, internal waters and territorial seas. If the tangible property in respect of which the service is provided is located in international waters or international airspace when the service is performed, the rule in paragraph 2 could result in those Adjusted Revenues being unallocated or disputes between Jurisdictions where the tangible property was located for a short time during the performance of the service about the level of allocations that should be made to those Jurisdictions. In order to mitigate the risk of Adjusted Revenues being unallocated or disputes arising between Jurisdictions, a deeming provision applies when tangible property in respect of which a *location-specific service* is provided is in international airspace or international waters. Where paragraph 3 applies, the tangible property is deemed to be located at the location of the customer when the service is performed and as such Adjusted Revenues would be allocated to that Jurisdiction.

2252. The rule in paragraph 3 applies to two categories of services connected to tangible property: services that result in the physical manipulation of property where substantially all of the service is performed at the location of the tangible property; and the lease, hire or licence to use tangible property.

2253. Paragraph 3(a) provides that when a service that results in the physical manipulation of property is performed when the tangible property is located in international airspace or international waters, the tangible property is deemed to be located at the location of the customer. For example, if a maintenance or repair service was provided on an oil rig that was in international waters when the service was performed, that service would be deemed to be performed at the location of the customer. Location of a person means the place where a person is habitually located (in the case of an individual); or if the customer is a business, the place where that business has its physical premises from where it conducts

the activities associated with the Adjusted Revenues. It is designed to identify the place where the customer is usually located. In the case of a business customer that may have more than one premises, the relevant premises is the one where it conducts the activities associated with the Adjusted Revenues. In the oil rig example, that would be the premises from where the operation of the oil rig is managed.

2254. Paragraph 3(b) provides that if tangible property that is leased, hired or subject to a license to use is located, or may be located, in international airspace or international waters during the term of the lease, hire or licence, the tangible property is deemed to be located at the location of the customer. In this respect paragraph 3(b) applies in slightly broader circumstances than paragraph 3(a), in that it also applies in circumstances where the tangible property may be located in international waters or international airspace. This reflects the fact that the lessors of tangible property such as ships and aircraft may have no information on where the ship or aircraft will be operated by the lessee during the term of the lease. Further, even though a ship or aircraft might operate primarily in international waters or international airspace, it will land or dock in different Jurisdictions to load and unload cargo and passengers and to refuel. As such, when a ship or aircraft is leased and is primarily operating in international waters or airspace, or where the ship or aircraft is leased to an international carrier, the Covered Group must apply this rule to deem the ship or aircraft to be located at the location of the customer (on the basis that it may be located in international waters or international airspace during the term of the lease) and allocate the Adjusted Revenues accordingly.

B – Advertising services

2255. Article 7(1)(d)(ii) and (iii) and Annex D Section 3(B) provide revenue sourcing rules for advertising services. It covers advertising services which are understood broadly to include the provision or facilitation of advertising. It also includes services for the purchase, storage and distribution of advertising and services that monitor advertising and measure their performance, as these services are directly linked to and facilitate the provision of advertising.

2256. The rule for sourcing Adjusted Revenues from advertising services is split into two categories, online advertising services (contained in Article 7(1)(d)(ii)) and other advertising services (contained in Article 7(1)(d)(iii)). The same source rule broadly applies to both, requiring Adjusted Revenues to be sourced to the place where the advertisement is directed or the viewer is located. The arrangement of this rule into sub-categories facilitates the application of appropriate indicators for each type of advertising. Recognising that it is inherent in the business model to be able to target advertising to intended viewers, Covered Groups deriving Adjusted Revenues from advertising services are expected to be able to have *reliable indicators* to source all Adjusted Revenues from advertising. As such, no *allocation key* is provided in the rule (although the default *allocation key* may be applicable in limited circumstances).

2257. Annex D Section 3(B)(1) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from advertising services.

Overview – Online advertising services

2258. Online advertising includes direct advertising services, such as where social media platforms, online search engines, online intermediation platforms and digital content providers directly sell advertising inventory for display on the digital interfaces (websites, etc.) they operate. Sales of online advertising through demand side platforms, supply side platforms and ad exchanges will be treated as online advertising. However, the Covered Groups providing the demand side platforms, supply side platforms and ad exchanges are treated as providing online intermediation services (provided that the Covered Group itself is not also the provider of the advertising service) and as such Adjusted Revenues from those services are sourced under the rules provided in Article 7(1)(d)(iv) and (v). Online advertising services also

extends to the purchase, storage and distribution of advertising messages, advertising analytic services and ad verification services. It also includes online advertising displayed on an Internet-connected good (“internet of things”).

Sourcing rule – Online advertising services

2259. Article 7(1)(d)(ii) states the sourcing principle which is that Adjusted Revenues from online advertising services are sourced to the location of the viewer of the online advertisement. The term viewer means the individual to whom an advertisement is displayed. This means that the Adjusted Revenues are sourced to the Jurisdiction(s) where the advertising is targeted, and not to the location of the business that pays for the advertising.

Indicators – Online advertising services

2260. Annex D Section 3(B)(2) sets out the indicators which could be used for online advertising services. These include the user profile information of the viewer; the geolocation of the device of the viewer on which the online advertisement is displayed; or the IP address of the device of the viewer on which the online advertisement is displayed. These indicators are relevant because information on the location of the viewer can be extracted from these data points. Recognising the data protection and privacy issues associated with collecting detailed information, the revenue sourcing rules require only that reliable information on the Jurisdiction where the viewer is located is used (and not further information such as city or address), and does not require that personal information on the viewer is collected or retained.

2261. User profile information includes a wide range of data identifying the viewer. There are two types of user profile information. The first one is created by the Covered Group, based on information it has available on the user and can include information on the user’s historical location at different points in time, their usual location, demographic characteristics (e.g. age, gender, nationality, or estimated income), as well behavioural characteristics (e.g. purchase history, Internet browsing data, or preferences derived from a user’s engagement on a Covered Group’s platform). The second one is created by the user itself which might include the user’s home address, telephone number (for which the Covered Group can use the country code as an indicator of the user’s location) and other location information. User profile information however it is generated can therefore assist the Covered Group in determining the location of the viewer.

2262. Geolocation data of the viewer’s device is based on GPS data or information that could be used to extrapolate a viewer’s location from a device. Access to this type of information will often depend on the viewer enabling location sharing on the device they are using. Broadly, geolocation services use various data points to determine the location of the user. These can include a combination of IP address, GPS-derived location data, cell tower IDs to which the user is connected, as well as data associated with Wi-Fi positioning systems.

2263. The Internet Protocol (IP) address (based on Wi-Fi or cellular IP address, depending on how the user is connected to the Internet) of the device of the viewer can also be used as an indicator for the location of the viewer. It is the number that is assigned to each device connected to a computer network, meaning that every device connected to the Internet has an IP address. Although an IP address does not inherently contain the location of the viewer, IP address databases are widely used by businesses to determine the location of viewers for business reasons. In such databases, certain ranges of IP addresses are assigned to certain Jurisdictions, which allows the Covered Group to identify the Jurisdiction from the IP address. The Covered Group can use different products or methods to track the IP address, all of which could be used for the purpose of applying the revenue sourcing rules.

2264. There is an overlap between these indicators in practice; for example, a user profile may include geolocation and IP address; and geolocation information would include an IP address. A Covered Group may use a combination of these indicators in applying the sourcing rule.

2265. As provided in Article 6(3)(b), another *reliable indicator* may also be used, if there is another type of information that identifies the location of the viewer. This could include any data that is or becomes available to a Covered Group in the ordinary course of business that can be used to identify the location of the viewer, e.g., data concerning user interactions such as “check-ins” to another user’s business premises.

Box 51. Example – Another reliable indicator for online advertising services

The following examples illustrate the principles of another *reliable indicator* in the context of online advertising services.

Example 1

The Covered Group provides online advertising services. The customer selects parameters for a campaign (e.g., tied to specific search terms and/or generalised locations). The Covered Group uses a combination of data points such as IP address, device location, billing information, user profile information and user interactions, as well as analytics and artificial intelligence to estimate location information about users of its site, to target the advertisements relevant to that profile. This information enables the Covered Group to more effectively identify potential customers for advertised products and services of the relevant customer business in question and is also used by the business to mitigate the impact of VPNs and other distortions for location data. Because the information on the viewers that were targeted is consistent with the sourcing rule (in that it seeks to identify the location of the viewers as opposed to the paying customers), and it is based on information used for commercial purposes (in that it is the information used to conduct the advertising business), it is another *reliable indicator* under Article 6(3)(b)(i).

Example 2

The Covered Group provides online advertising services. The Covered Group targets users in a certain region, as evidenced by the language of the advertising and the underlying products being advertised which are specific to Jurisdictions A and B. The population of Jurisdiction A is five times that of Jurisdiction B; however based on IP addresses, the number of viewers in Jurisdiction B is much higher than that of Jurisdiction A, and much higher than the actual population of Jurisdiction B. The Covered Group is aware that the use of VPN by users located in Jurisdiction A is high. It conducts market research as well as analytics on the user profiles. It estimates that 65 per cent of the viewers that appear (based on IP address) to be in Jurisdiction B are in fact located in Jurisdiction A. It acts on this information in its reports to customers and redeploys more specifically targeted advertising on this basis. It reallocates the Adjusted Revenues as follows:

- Advertising Adjusted Revenues attributed to Jurisdiction A: based on IP addresses in Jurisdiction A + 65 per cent of IP addresses in Jurisdiction B;
- Advertising Adjusted Revenues attributed to Jurisdiction B: based on 35 per cent of IP addresses in Jurisdiction B.

Because this information is consistent with the sourcing rule (in that it identifies the location of the viewers), and it is based on information collected for commercial purposes (in that it is the information used to conduct the advertising business and report to customers), it is another *reliable indicator* under Article 6(3)(b)(i). See also discussion below in connection with VPN use.

2266. The first element of the *reliable indicators* test in Article 6(3)(b) is that the indicators produce results consistent with the sourcing rule, which is the location of the viewer. In the context of online advertising services, this does not require that the Covered Group attempt to comprehensively track the use of VPNs by users, nor does it require attempting to “break through” a VPN (given that this is not currently technologically feasible), even though this means that the IP address may not accurately indicate the location of the viewer.

2267. However, if the Covered Group already takes steps to detect or respond to VPN use as part of delivering accurately targeted advertising to its business customers, or preventing fraud, then the information used to do so should be taken into account for revenue sourcing under these rules. For example, a Covered Group already makes efforts to monitor the jurisdictional breakdown of IP addresses and detects that there is a disproportionate result in a small Jurisdiction (as outlined in Example 2 above) which is one where the use of VPN is common (based on market research). To be able to offer more sophisticated and accurate advertising, it gathers user profile information, which provides information to suggest the actual location of certain users. In this case, because the Covered Group is already undertaking such efforts as part of its service delivery, the user profile information would be considered the *reliable indicators* and should be used to the extent available, and not the IP address.

2268. Article 6(3)(b)(ii) facilitates the use of an alternative *reliable indicator* to identify the location of the viewer. In the context of online advertising, it is expected that alternative *reliable indicators* will frequently be used by Covered Groups as they should obviate the requirement to identify viewers and the associated Adjusted Revenues on an impression-by-impression basis, a task which typically not be feasible given the vast quantity of annual impressions of advertisements issued by in-scope online advertisers (which for some Covered Groups may be billions or trillions in a year).

Box 52. Examples – Alternative reliable indicator for online advertising services

The following examples illustrate the principles of an alternative *reliable indicator* in the context of online advertising services.

Example 1

The Covered Group provides online advertising services. The Covered Group has a range of pricing arrangements; under some arrangements it charges its customer based on the number of views of each advertisement (“impressions”), and in others it charges based on the number of clicks on the advertisement, while in others it charges based on whether the viewer ultimately purchases the advertised product. It does not have a set price for its advertising, meaning there is not a set price difference for advertising targeted to viewers in a given Jurisdiction. This is because of the way advertising is sold to the market, which is through an auction system, where actual prices for advertising change rapidly, many times a day, based on real time supply and demand for certain advertising (such as when advertising connected to a certain search term is priced higher than other search terms). The auction system, combined with the fact that, among other things, certain arrangements charge on

different models, and that ultimately adjustments are made in the billing system to account for spam and fraud, makes it unduly burdensome to track the Adjusted Revenues generated on a per-impression or per-click basis, and a more aggregated approach to reasonably approximate the Adjusted Revenues associated with viewers in each Jurisdiction is needed.

The Covered Group designs its revenue sourcing method starting with the data on all impressions, rather than running separate sourcing methods based on each billing model (i.e. the per click charging or the per action charging). The reason is that the existence of measurable impressions is the common factor across all models, regardless of the billing approach. It then identifies the Adjusted Revenues charged to customers (i.e. the businesses paying for advertising) each month. This aggregates multiple advertising campaigns that all customers may have at one time, looking on a monthly basis as customers are billed monthly. For that amount of Adjusted Revenues earned, it identifies the breakdown of targeted viewers based on the Jurisdiction in which they were located. However, because the Covered Group knows that the trend in the online advertising business is that there are pricing differences for different Jurisdictions, this method would not take into account pricing differences and would allocate the Adjusted Revenues to each Jurisdiction in proportion to the number of impressions. To account for pricing differences, the Covered Group weights the viewers in each Jurisdiction. As there is not a set price charged for advertising per Jurisdiction, and it would be unduly burdensome to track the ultimate Adjusted Revenues attributed to each impression, it uses the *global allocation key* as the weighting to take account of pricing differences. The calculation for the month is as follows (and which is then aggregated at the end of the year to prepare the totals).

- Revenues from online advertising for the month: EUR 100m
- Number of impressions:
 - Jurisdiction A: 5m
 - Jurisdiction B: 10m
 - Jurisdiction C: 5m
 - Total: 20m
- The respective shares of *final consumption expenditure* under the *global allocation key* are:
 - Jurisdiction A: 10 per cent
 - Jurisdiction B: 3 per cent
 - Jurisdiction C: 24 per cent
 - Allocation multiplier: $100\text{m} / (5\text{m} \times 10\text{ per cent}) + (10\text{m} \times 3\text{ per cent}) + (5\text{m} \times 24\text{ per cent}) = 50$
- Weighted share of Adjusted Revenues:
 - Jurisdiction A: $(5\text{m} \times 10\text{ per cent}) * 50 = 25\text{m}$
 - Jurisdiction B: $(10\text{m} \times 3\text{ per cent}) * 50 = 15\text{m}$

- Jurisdiction C: (5m x 24 per cent) * 50 = 60m

The Covered Group applies for *advance certainty* to use this as an alternative *reliable indicator*. In doing so it must explain the reasons for using the proposed proxy instead of the indicators enumerated in Annex D (i.e., that it would be unduly burdensome to track, analyse and store the data points included as enumerated indicators for each ad published given the number of ads and viewers of each ad) as required by Article 6(3)(b)(ii)(A). It must also outline to the *review panel* (or the *determination panel*) the reasons why it believes the approach produces results consistent with the sourcing rule (in that it identifies the location of the viewers) as required by Article 6(3)(b), and must demonstrate that the approach can be shown to be otherwise reliable as required by Article 6(3)(b)(ii)(A). In demonstrating that the information is otherwise reliable, the Covered Group would explain why impressions are a reasonable proxy for the other charging mechanisms it uses. As the use of *final consumption expenditure* to reflect pricing differences is broadly consistent with the default rule, that aspect of the approach would meet the otherwise reliable standard.

Example 2:

The Covered Group provides online advertising services on a social media platform. The social media platform has particularly high active participation rates in Jurisdiction A, which is disproportionately high compared to the size and economy of Jurisdiction A, and is frequently used by advertisers wishing to target potential customers in Jurisdiction A. Given the high active participation rates in Jurisdiction A, the Covered Group's pricing policy is to always charge higher rates to target users in Jurisdiction A (typically one and a half times the price of the next highest Jurisdiction) and this is reflected in rate cards if and when they are issued to customers. The Covered Group has a range of pricing models; under some arrangements it charges its customer based on the number of impressions, and in others it charges based on the number of clicks on the advertisement, while in others it charges based on whether the viewer ultimately purchases the advertised product. While the Covered Group always charges the highest price for Jurisdiction A (even where advertising is sold through an auction system as described in Example 1), it does not have a set price for its advertising targeted to viewers in other Jurisdictions. The auction system, pricing arrangements, and adjustment system to account for spam and fraud, makes it unduly burdensome to track the Adjusted Revenues generated on a per-impression or per-click basis, and a more aggregated approach to reasonably approximate the Adjusted Revenues associated with viewers in each Jurisdiction is needed.

Similar to Example 1, the Covered Group designs its revenue sourcing method starting with the data on all impressions, the Adjusted Revenues charged to customers and the breakdown of targeted viewers based on the Jurisdiction in which they were located. However, because the Covered Group always charges higher prices to target viewers in Jurisdiction A, it cannot use *final consumption expenditure* alone to reflect for pricing differences as *final consumption expenditure* would not reflect the price weighting in favour of Jurisdiction A.

Overview – Advertising services other than online advertising services

2269. The second sub-category covers advertising other than that displayed online. It includes audio and visual advertising, such as radio and television advertising, advertising in magazines, newspapers and other journals, billboard and similar advertising displayed at a fixed place or affixed to a mobile object (e.g., advertisement on a bus or other vehicle), advertising at sporting events and on sporting uniforms. Ancillary advertising Adjusted Revenues earned by a Covered Group operating transport services are sourced as Transport Adjusted Revenues under Article 7(1)(d)(vi).

2270. Television, radio and print media may also make their content available online. Where separate advertising Adjusted Revenues are generated from content made available online, that should be treated as online advertising services and sourced accordingly. Where it is the same broadcast or print copy that is replicated or accessible online, meaning the same ads are displayed or transmitted in both the online and non-online broadcast, and the Adjusted Revenues from online transmission are not separately charged or monitored, the Adjusted Revenues from those services should be sourced according to their predominant character. In the case of traditional free to air television and radio channels, the more important part has been the display through the non-online format, to which the online format is an addition rather than the central feature. In the case of satellite or cable television, the predominant part would be determined on a case-by-case basis, depending on the primary distribution method. In any case, because the sourcing principle is the same in both cases, and because in either case another *reliable indicator* is permitted meaning that both online or offline indicators may be reliable in a given case, this overlap between online and non-online advertising may in practice not create material difficulties.

Sourcing rule – Advertising services other than online advertising services

2271. Article 7(1)(d)(iii) states the sourcing principle which is that Adjusted Revenues from advertising services other than online advertising services arise at the place of display or reception of the advertisement. The sourcing rule is not drafted by reference to the “viewer” as is the case for online advertising. This is to account for non-visual advertising, where there may not be a “viewer”. For the same reason, the reference to the “reception” of the advertisement is to account for advertising that is audio only, such as on radio. However, similar to online advertising, this sources Adjusted Revenues to the Jurisdiction(s) where the advertising is targeted and not to the location of the business that pays for the advertising, and as such the underlying concept of the source Jurisdiction is the same whether the advertising is online or not.

Indicators – Advertising services other than online advertising services

2272. Annex D Section 3(B)(3) sets out the indicators which could be used for other advertising services. The appropriate indicator will depend on the type of advertising; in some cases, the advertising will be physically displayed and the location is likely to be easily identified; in other cases, the advertising will be displayed through media and a different approach is needed to articulate the place of display or reception.

2273. Paragraph 3(a) relates to physical billboard advertising (for example, on a roadside, building, or vehicle); in this case, an indicator is the location of the billboard. As noted below, if the billboard advertising is sold in a location where it is intended to be televised, that advertising is more appropriately treated as television advertising and should be sourced accordingly.

2274. Paragraph 3(b) relates to advertisement included in newspapers, magazines, journals or other publications; in this case, an indicator is the Jurisdiction where the publication is circulated or expected to be circulated. The Jurisdiction of circulation includes places of sale (for example, by retailers) as well as places of delivery (for example, where publications are mailed directly to subscribers). The reference to the expected circulation is included to clarify that the Covered Group is not expected to source advertising Adjusted Revenues to the actual location of the viewer at the time that they look at the advertising. This is necessary because it recognises the fact that publications are moveable rather than fixed (as is the case of a billboard); for example, a magazine may be sold at an international train station and only opened by the viewer when they arrive in the neighbouring Jurisdiction. The place of expected circulation in such cases refers to the place of sale, and not the ultimate place to which the publication is taken and subsequently viewed.

2275. Paragraph 3(c) relates to advertising displayed on television or broadcast on radio; in this case, an indicator is the Jurisdiction where the television or radio programming is received or expected to be

received. This includes billboard advertising if the billboard that displays the ads is regularly televised and advertising is sold and purchased with such broadcast in mind. For example, advertising displayed on billboards in sports stadiums would be regarded as displayed on television if the majority of the events held at that stadium are televised. The reference to the Jurisdiction the programming is expected to be received is included to clarify that the Covered Group is not expected to source advertising Adjusted Revenues to the actual location of the viewer at the time that they look at the advertising, as is the case in paragraph 3(b). This provides for cases where the viewer is located elsewhere at the point of viewing the advertisement, for example, if they have recorded a television programme and subsequently view it in another Jurisdiction, or where the programme is replicated in online format (and not separately sourced under the online advertising rule by virtue of the application of the predominant character rule) and viewed or received in another Jurisdiction. The place of expected receipt of the programming in such cases refers to the place the Covered Group ordinarily anticipates the viewer will be located, for example, based on the location of its broadcasting rights and infrastructure, or based on user subscription information, and not the ultimate place to which a recording of the broadcast may be taken and subsequently viewed.

2276. Paragraph 3(d) relates to all types of advertising, and provides that an indicator also includes information included in the contract or other commercial documentation as to where the advertising will be displayed or received. This may apply for cases where the physical viewing of the advertising is not immediately discernible from the format of that advertising (as in the cases above), but where the contractual information provides information that can be relied upon.

2277. As provided in Article 6(3)(b), another *reliable indicator* or an alternative *reliable indicator* may also be used, if there is another type of information that identifies the place of display or reception of the advertisement.

C – Online intermediation services

Overview

2278. Article 7(1)(d)(iv) and (v) and Annex D Section 3(C) provide revenue sourcing rules for online intermediation services. Online intermediation services mean online platforms that enable users to offer goods and services for sale to one another and where the fees earned are dependent on the conclusion of contracts between the users. This category would apply where the service enables the interaction between third party users resulting in the conclusion of a contract between those users, irrespective of the nature of the interaction, the characteristics of the users involved, or the extent of the service provider's activities in facilitating the interaction. It applies to all types of online intermediation services whether in respect of finished goods, hotel services, short-term letting services, taxi services, sales and purchase of advertising (including supply side platforms, demand side platforms and ad exchanges where Covered Group providing the platform or ad exchange is not also the provider of the advertising service). This category covers cases where the online intermediation platform charges users commission or other fees for the conclusion of *transactions* with other users on the platform.

2279. The online intermediation service is separate to the underlying *transaction* it facilitates. As such, in the context of online intermediation services, there are typically two *transactions*: the online intermediation service (to which Article 7(1)(d)(iv) and (v) and Annex D Section 3(C) apply for sourcing the fee / commission); and the underlying *transaction*. The underlying *transaction* is relevant in that the parties to that underlying *transaction* will generally determine how the sourcing rule applies; but the Adjusted Revenues from that underlying *transaction*, such as the payment for the hotel, is not sourced under this provision. In other words, the online intermediation service is between the platform provider and the users of the platform whereas the underlying *transaction* is between the users only (which are described in the rules in Article 7(1)(d)(iv) and (v) and Annex D Section 3(C) as the purchasers and sellers).

2280. Online intermediation services do not cover services provided by the online platform that are not dependent on the conclusion of contracts. For example, a subscription fee paid by a user for the right to use the platform but which does not depend on sales being in fact concluded by the user on the platform would be treated as another service under Annex D Section 3(F).

2281. Online intermediation services do not include the online sale of goods and services which form part of the platform's own inventory (which may however be captured as sales of finished goods or services). The distinction between an intermediation service and selling a Covered Group's own inventory is that in the latter case, the Covered Group takes on ordinary commercial risks associated with the provision of the underlying product, such as inventory risk, product liability risk and credit risk. However, the Covered Group may have certain discretion to determine the price of the underlying *transaction* within a range, this does not by itself mean that it is selling its own inventory.

2282. For example, an intermediary operates an online gaming store where it sells computer games that it has acquired from unrelated gaming businesses. This is different to an online intermediation services platform as the online gaming store owns the games it sells to its customers. In that respect it takes inventory risk, product risk and is exposed to credit risk for the full price of the games it sells. In that role, it would be treated as deriving Adjusted Revenues from finished goods (or digital content if the games are not in hard copy) under the revenue sourcing rules (which it does by acting as an independent distributor or reseller, respectively). In practice, online intermediation services platforms generally do not take ownership of the goods that are the subject matter of the underlying *transactions* and the credit risk is limited to the level of the intermediation fee or commission it charges.

2283. There are, however, some limited examples where in practice, an online marketplace that operates a resale model would continue to be treated as providing online intermediation services. Those cases involve the marketplace taking flash title only of the underlying goods or services, and only acquires goods on the condition there is a successful *transaction*. The consolidated financial statements of the Covered Group record the intermediation service fee, or the spread between the price the goods or services were acquired for and the price they were resold for, earned in respect of the *transaction* rather than the sale and purchase of the underlying good or service. As such, it is earning the functional equivalent to the commission earned by an online intermediation platform, and not the equivalent to the Adjusted Revenues for the sale of goods or services themselves. In those cases, the online marketplace should continue to be treated as an online intermediation service, even though it is a reseller or independent distributor under the legal arrangements. This is a result of the application of the substance over form test, which applies if the ordinary or predominant character of Adjusted Revenues (in this case, the service fee) is ambiguous – which would be the case where a Covered Group that operates an online intermediation platform effects a portion of the intermediation *transactions* by taking flash title. The substance over form test serves to ensure that in analysing the ordinary or predominant character, the legal form takes on only secondary importance.

2284. In cases where a Covered Group takes flash title after there is a successful *transaction* on the platform to facilitate *transactions* between users of its intermediation platform, legally the Covered Group would be considered to act as an independent distributor or reseller. However, in substance the arrangement would be categorised as an online intermediation service applying the criteria identified in paragraph 255 given:

- the purpose of the Covered Group is to facilitate *transactions* between users of its platform;
- the purpose of the users of the intermediation platform is to identify suitable counterparties with whom to transact and buy or sell the relevant good or service;

- the expected commercial benefit for the Covered Group is to earn the transaction fee and that is recorded in the consolidated financial statements;
- the Covered Group does not hold inventory, is not exposed to credit risk in respect of the full value of the good or service, and does not bear risk in relation to defective products or other complaints with respect to the underlying product or service;
- the expected commercial benefit for the users is to gain access to a range of potential counterparties, the purchasing user is obliged to pay for the good or service that is the subject of the *transaction* and the selling user is obliged to deliver that good or service;
- in the broader commercial context, the Covered Group holds itself out as offering a service that facilitates the purchase and sale of goods and services.

2285. As substance prevails over legal form, the Adjusted Revenues would be categorised as Adjusted Revenues from an online intermediation service.

2286. Another example is an online marketplace for car hire operating on a resell model. After a user secures a reservation for a car rental service through the online platform, the platform service provider purchases the car rental service itself, after receiving the customer's order, before immediately reselling it to the customer. Given that the platform service provider holds itself out as an online marketplace, is not incurring any of the ordinary commercial risks associated with the provision of the underlying car rental service (e.g. inventory risk), and that purchasing users use the service to identify the best deals available from a range of providers, the substance of the arrangement will prevail over its legal form. As such, the service would be categorised as an online intermediation service and the Adjusted Revenues (the service fee recorded in the consolidated financial statements) should be sourced under Article 7(1)(d)(v) and Annex D Section 3(C).

2287. There are two separate rules for online intermediation services; Article 7(1)(d)(iv) and Annex D Section 3(C)(2) relate to online intermediation of tangible goods, digital content or services other than *location-specific services*; and Article 7(1)(d)(v) and Annex D Section 3(C)(3) relate to online intermediation of *location-specific services*. In both cases, the Adjusted Revenues of the online intermediation service provider are split between the two markets; the purchaser and the seller in the case of the former, and the purchaser and the place of performance in the latter. No distinction is made between cases where the online intermediation service fees are charged to the purchaser, seller or both. Likewise, no distinction is made based on the form of transmission of the revenue; for example, the rules apply to service fees charged by the Covered Group for the provision of the online intermediation service and to amounts that are deducted as commissions or service fees from purchase prices received from purchasers for payment to the seller in respect of the underlying *transaction* (which the Covered Group is obliged to pass on to the seller).

2288. Annex D Section 3(C)(1) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from online intermediation services.

Overview – Online intermediation of tangible goods, digital content or services other than *location-specific services*

2289. Article 7(1)(d)(iv) and Annex D Section 3(C)(2) relate to Adjusted Revenues from online intermediation services that facilitate the sale of tangible goods, digital content and services other than *location-specific services*. Tangible goods means finished goods and components. Digital content includes online music, books, videos, text, games, applications, computer programmes, software, online

newspapers, online libraries and online databases. Any other service that is intermediated is also captured in this rule, other than *location-specific services* discussed below. Typical examples of these online intermediation platforms include online shopping for new or second hand goods not owned by the platform, online stores selling mobile phone applications not owned by the platform, or online marketplaces where users offer their services as employees or labourers.

Sourcing rule – Online intermediation of tangible goods, digital content or services other than *location-specific services*

2290. Under Article 7(1)(d)(iv)(A), 50 per cent of these online intermediation service Adjusted Revenues are sourced to the location of the purchaser. Purchaser means the party making a payment under a contract to acquire a good or service, i.e., those users that acquire goods and services under *transactions* facilitated by the online intermediation service.

2291. Article 7(1)(d)(iv)(B) states the sourcing principle for the other 50 per cent of Adjusted Revenues from these online intermediation services, which are sourced to the location of the seller. Seller means the party providing the good or service under a contract with a purchaser, i.e., those users that provide goods and services under the underlying *transactions*.

2292. The term location means the place where a person is habitually located in the case of an individual; or if the person is a business, the place where that business has its physical premises from which it conducts the activities associated with the Adjusted Revenues in question. If both the purchaser and the seller are in the same Jurisdiction, 100 per cent of the Adjusted Revenues from the Intermediation Service will be sourced to that Jurisdiction.

Indicators – Online intermediation of tangible goods, digital content or services other than *location-specific services*

2293. Annex D Section 3(C)(2)(a) sets out the indicators which could be used for online intermediation of tangible goods, digital content or services other than *location-specific services* with respect to the location of the purchaser. Those indicators are:

- The delivery address of the purchaser, which would be relevant where the online intermediation service facilitates the sale of a tangible good.
- The billing address of the purchaser, which may be available to the Covered Group either by virtue of the *transactions* concluded by the purchaser on the platform, or where the purchaser pays transaction fees to the Covered Group.
- User profile information of the purchaser. User profile information includes a wide range of data identifying the purchaser, whether it is a profile created by the Covered Group, or created by the user itself, and which may include location information. See further discussion of user profile information above, under online advertising services.
- Geolocation data of the purchaser's device through which the purchase is made. This is based on GPS information that could be used to extrapolate a purchaser's location from a device. See further discussion of Geolocation data above, under online advertising services.
- The IP address (based on Wi-Fi or cellular IP address, depending on how the user is connected to the Internet) of the device of the purchaser can also be used as an indicator for the location of the purchaser. See further discussion of IP address above, under online advertising services.

- Another *reliable indicator* as permitted by Article 6(3)(b)(i).
- An alternative *reliable indicator* as permitted by Article 6(3)(b)(ii).

2294. Annex D Section 3(C)(2)(b) sets out the indicators which could be used for online intermediation of tangible goods, digital content or services other than *location-specific services* with respect to the location of the seller. These are the billing address; the user profile information; another *reliable indicator*; or an alternative *reliable indicator*. This is a more limited version of the indicators listed to identify the location of the purchaser. However, this would not preclude the Covered Group from using other indicators as another *reliable indicator*, such as the delivery address (for example, where that information is available to facilitate cases where tangible goods are returned to the seller), or the geolocation or IP address of the device of the seller to determine the location of the seller (for example, where the seller is an individual or a business that usually accesses the platform from one Jurisdiction). Article 6(3)(b) further permits the use of another *reliable indicator* or an alternative *reliable indicator* to source Adjusted Revenues from online intermediation services.

Box 53. Examples – Another reliable indicator for online intermediation services

The following examples illustrate the principles of another *reliable indicator* in the context of online intermediation services.

Example 1

The Covered Group operates a platform facilitating the sale of tangible goods. It does not operate in all Jurisdictions, but does operate in Jurisdiction A, which is neighboured by Jurisdiction B. As part of its commercial practices to inform strategic decisions about marketing and expansion, it undertakes a periodic review of the delivery addresses on file. As part of this exercise, it identifies a significant number of deliveries made to a freight-forwarding contractor, located close to the border of Jurisdiction B. In this case, this information is evidence that for that portion of sales, the delivery address is not reliable, because it is not consistent with the sourcing rule, which is the location of the purchaser (which is the person acquiring the goods, not the freight forwarding contractor). For purposes of its marketing strategy, it records those purchasers as purchasers in Jurisdiction B. Although the requirements of reliability do not require the Covered Group to actively investigate every *transaction*, because it is already undertaking this information gathering in the course of its commercial operations, it should not use the delivery address for that portion of sales. However, the Covered Group could rely on the inferences it has drawn for purposes of its marketing strategy, i.e., that the portion of sales are acquired by purchasers in Jurisdiction B. The Covered Group sources this portion of sales to Jurisdiction B. Because this information would be consistent with the sourcing principle, and is information the Covered Group has obtained in furtherance of its own commercial purposes, this would qualify as another *reliable indicator* under Article 6(3)(b)(i).

Example 2

The Covered Group operates a platform facilitating the sale of tangible goods. It operates and delivers goods to Jurisdictions in Europe. It always obtains the credit card details of its sellers as part of the initial registration of the seller, to be able to charge them the fee for providing the intermediation service. The location of the issuing banks is automatically captured from the credit card numbers and that information is used as another *reliable indicator* for the location of the seller. As part of its commercial practice, the Covered Group has an automated function which checks the credit card details on file, to ensure that they are up to date and alert the Covered Group where a credit card expires. As part of this

exercise, a report is generated which identifies a significant number of credit card numbers which are associated with one particular bank located in Asia. These credit card numbers do not appear to be consistent with the sourcing rule, which is the location of the seller and which means the place where that business has its physical premises from where it operates. Given that the Covered Group is delivering goods in Europe, it would be expected that the sellers are also located in Europe. However, the Covered Group examines the other commercial information obtained about these sellers, including the trading name, customer feedback and customs importation information, which indicate that the businesses are in fact ordinarily operating their businesses in Asia. Although the requirements of reliability do not require the Covered Group to actively investigate every indicator, because it is already undertaking this information gathering in the course of its commercial operations, the information should be used. In this case, the reliability of the credit card numbers has been further confirmed through the other information. Because this information would be consistent with the sourcing principle, and is information the Covered Group has obtained in furtherance of its own commercial purposes, the information on the credit card numbers would qualify as another *reliable indicator* under Article 6(3)(b)(i).

Overview – Online intermediation of *location-specific services*

2295. Article 7(1)(d)(v) and Annex D Section 3(C)(3) relate to Adjusted Revenues from online intermediation services that facilitate the provision of *location-specific services*. *Location-specific services* is defined and discussed in Annex D Section 3(A) above. Typical examples of these online intermediation platforms include the intermediation of passenger transport services including flights, taxis, ride-sharing, as well as online intermediation services in respect of hotels, accommodation and concert tickets.

Sourcing rule – Online intermediation of *location-specific services*

2296. Article 7(1)(d)(v)(A) states the sourcing rule in respect of 50 per cent of these online intermediation service Revenues, which are sourced to the location of the purchaser.

2297. Article 7(1)(d)(v)(B) states the sourcing rule in respect of the other 50 per cent of these online intermediation service Adjusted Revenues. It is sourced to the place of performance of the *location-specific service*. This reflects the special nature of *location-specific services* which are so tied to the location where they are performed, and which are the basis on which the purchaser has sought the service, and which justify that Jurisdiction being regarded as the market for 50 per cent of the Adjusted Revenues for the purposes for the Convention.

2298. Identifying the place of performance for the vast majority of underlying *location-specific services* should be relatively straightforward. For example, where the online intermediation service facilitates a hotel booking, the place of performance of the underlying hotel service is the location of the hotel and 50 per cent of the Adjusted Revenues should be sourced to that Jurisdiction. Similarly, for an online intermediation service that facilitates a taxi booking, the place of performance of the underlying taxi service will be the Jurisdiction where the taxi ride takes place and 50 per cent of the Adjusted Revenues should be sourced to that Jurisdiction. However, if the online intermediation service facilitates an international flight (or other cross-border passenger transport service), identifying the place of performance of that transport service is challenging. Accordingly, in those cases, the Covered Group may treat the place of destination of the underlying passenger transport service as the place of performance of that service for purposes of the online intermediation rule. This also reflects the broad approach taken for passenger transport services.

Box 54. Example – Online intermediation of cross-border passenger transport services

The following example sets out how Adjusted Revenues of a Covered Group for online intermediation services are sourced.

A Covered Group operates a platform for online intermediation services that facilitates the sale and purchase of domestic and international flights. The purchasers of the flights are based in three Jurisdictions, Jurisdiction A, Jurisdiction B and Jurisdiction C and the flights sold operate between and within those same three Jurisdictions and additionally in Jurisdiction D. During a Period, the Covered Group earns the following from facilitating the sale and purchase of international and domestic flights:

Destinations (columns) / Purchasers located in (rows)	A	B	C	D	Total
A	15	1	2	3	21
B	5	2.5	3.5	2	13
C	10	1.5	12.5	2	26
Total	30	5	18	7	60

Allocation to Jurisdiction A:

(50 per cent if purchaser located in Jurisdiction A) + (50 per cent if Jurisdiction A is the destination) =

$$(50 \text{ per cent} \times 21) + (50 \text{ per cent} \times 30) = \mathbf{25.5}$$

Allocation to Jurisdiction B:

(50 per cent if purchaser located in Jurisdiction B) + (50 per cent if Jurisdiction B is the destination) =

$$(50 \text{ per cent} \times 5) + (50 \text{ per cent} \times 13) = \mathbf{9}$$

Allocation to Jurisdiction C:

(50 per cent if purchaser located in Jurisdiction C) + (50 per cent if Jurisdiction C is the destination) =

$$(50 \text{ per cent} \times 18) + (50 \text{ per cent} \times 26) = \mathbf{22}$$

Allocation to Jurisdiction D):

(50 per cent if purchaser located in Jurisdiction D) + (50 per cent if Jurisdiction D is the destination) =

$$(50 \text{ per cent} \times 0) + (50 \text{ per cent} \times 7) = \mathbf{3.5}$$

Indicators – Online intermediation of *location-specific services*

2299. Annex D Section 3(C)(3)(a) sets out the indicators which could be used for online intermediation of *location-specific services*, with respect to determining the location of the purchaser. Those indicators are the billing address, the user profile information, the geolocation of the device, or the IP address of the device, another *reliable indicator*, or an alternative *reliable indicator*. The discussion above on paragraph 2(a) is also relevant in connection with those indicators.

2300. Annex D Section 3(C)(3)(b) sets out the indicators which could be used for online intermediation of *location-specific services*, with respect to determining the location where the tangible property is expected to be located or the service is performed. These would be the same as the indicators used under Section 3(A)(2)(a) and (b) above. The Covered Group is required to identify the Jurisdiction where the tangible property is expected to be located or the Jurisdiction where the customer or its agent is expected to be located when the service is performed. The inclusion of the phrase “is expected to be” reflects the fact that the underlying service is performed by a third party and not by the Covered Group itself. As such, the Covered Group can only identify the place where it expects the tangible property or customer to be located based on the information it has.

D – Transport services

Overview

2301. Article 7(1)(d)(vi) and (vii) and Annex D Section 3(D) provide revenue sourcing rules for transport services.

2302. Transport services cover both air transport (e.g. services provided by airlines) and non-air transport (e.g. shipping, rail and road). Adjusted Revenues from leasing aircraft and ships are categorised as derived from a *location-specific service*, in Article 7(1)(d)(i) and Annex D Section 3(A) above.

2303. Passenger transport services means both (i) services for carrying passengers from one location to another; and (ii) connected ancillary services. Article 7(1)(d)(vi) provides a sourcing rule in respect of passenger transport services (which is the place of destination), and Article 7(1)(d)(vii) provides a sourcing rule in respect of cargo transport services (which is split equally between the place of origin and place of destination). The sourcing rule recognises that the customer engages the transport service to move a person or good from the place of origin to the place of destination, and as such, both end points represent the place of use and therefore the market Jurisdiction. However, as a simplification, given that in the case of passenger transport services the passenger ordinarily makes a return journey, it is only necessary to source to one of those end points given that the other will be the market Jurisdiction on the return. As such, for passenger transport services, the place of destination is used.

2304. The Adjusted Revenues being sourced are those derived by the transport-providing Covered Group for providing the service, and not the Adjusted Revenues derived by other entities outside the Covered Group that may be providing a related service, such as a connecting transport service to deliver the person or good to or from the transport-providing Covered Group’s service. As such, the origin or destination is the place that the transport Covered Group has been engaged to on-board / upload from and deliver to, respectively. It is not the prior place of origin of the person or good, or the ultimate destination of the person or good, where that prior or onward journey is not what the Covered Group has been engaged to provide.

2305. This means that the Covered Group would not be required to find out from other transport providers where the passengers or goods were originally transported from or are ultimately intended to be delivered. For example, if a Covered Group is engaged to ship cargo from A to B, the origin is A and the destination

of B, irrespective of whether the cargo originated in a factory in X and was finally delivered to a factory in Y.

2306. Alternatively, and perhaps more unusually in practice, is where Company X is engaged to transport cargo from A to B, where A and B are both inland and Company X only operates ships. Company X operates the sea-leg of the journey (Port C to Port D) and engages sub-contractors for the overland transport. Company X engages Company Y to transport the cargo from A to Port C and Company Z to transport the cargo from Port D to B. As Company X is engaged to transport the cargo from A to B, the place of origin will be A and the place of destination will be B. If Company Y was also a Covered Group, the place of origin for the purpose of the Convention would be A and the place of destination would be Port C.

2307. Annex D Section 3(D) provides more detail on applying those revenue sourcing rules, and is arranged in two parts: revenue sourcing rules for air transport services (addressing passenger and then cargo); and revenue sourcing rules for non-air transport services (addressing passenger and then cargo).

2308. Unlike the other revenue sourcing rules, the rules for transport services do not provide for the use of enumerated indicators and they do not prioritise the use of indicators. They permit Covered Groups to use either a transport-specific *allocation key* or another *reliable indicator* or an alternative *reliable indicator*. As the rules for transport services do not include enumerated *reliable indicators*, the requirement under Article 6(3)(a)(iv)(B) to take reasonable steps to use enumerated *reliable indicators* before using the *allocation keys* is disapplied by Article 6(3)(a)(iii).

2309. The *allocation keys* use Group-level aggregate information on the transport services provided over the course of the Period, which is then allocated in proportion to the place of origin or destination, as applicable. This approach has been taken because, although these Covered Groups have information on the origin and destination, and number and identity of passengers flown or packages carried in the vast majority of cases, they cannot then tie these data points to the amount of Adjusted Revenues earned at a transactional level. Broadly, this reflects that transport Covered Groups operate their 'inventory' in a very different manner than other industries, as well as that (by virtue of the usual treatment of income from international shipping and air transport under bilateral tax treaties) there are no existing legal or commercial requirements to maintain separate accounts in respect of the individual Jurisdictions they operate in but rather one set of accounts that records Adjusted Revenues on a global basis. Taking this approach also addresses the complexities that would otherwise arise in connection with code-sharing and interlining arrangements, and volume contracts.

2310. Annex D Section 3(D)(1) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from transport services.

Overview – Passenger air transport services

2311. Passenger air transport services means both (i) services for carrying passengers from one location to another by air; and (ii) connected ancillary services. The inclusion of the connected ancillary services reflect the fact that airlines may also earn a relatively small amount of other income, such as from code-sharing arrangements, interlining, on-board sales of food and consumer goods, entertainment services, on-board advertising, and operation of terminal lounges. These are the services that would not be provided by the air transport group in the absence of providing the passenger services itself, and which are ancillary to the provision of the passenger services. Although a separate rule could be written for each *transaction* (such as an on-board sale of perfume is a sale of a finished good), this would pose a disproportionate administrative burden, in particular when these *transactions* take place in international airspace, and given the relatively small size of the Adjusted Revenues. Without this rule, it would be expected that the Covered

Group could have used the Article 6(3)(a)(ii) (for supplementary Adjusted Revenues), resulting in the treatment of such Adjusted Revenues as passenger air transport services. However, by including such Adjusted Revenues as always part of passenger air transport services, it simplifies the rule and avoids the necessity of splitting out those Adjusted Revenues and separately applying the rule for supplementary Adjusted Revenues rule. Instead, these other Adjusted Revenues are sourced using the same *passenger air transport allocation key*. Note that certain customer reward program Adjusted Revenues are discussed separately in Annex D Section 3(E) below.

Sourcing rule – Passenger air transport services

2312. Article 7(1)(d)(vi)(A) states the sourcing rule, which is to source to the Jurisdiction in which the passengers disembark. Unlike passenger non-air transport services, no distinction is made as between a Jurisdiction that is, from the passenger's perspective, a transit stop, a brief stopover, or a final destination. This recognises that it will usually not be known to the air transport group whether the customer is transiting or not (due to the ubiquity of code-sharing and interlining arrangements by airlines), whether they will clear customs or how long they stay in the Jurisdiction.

Allocation Key – Passenger air transport services

2313. Annex D Section 3(D)(2)(a) provides that such Adjusted Revenues may be sourced using the *passenger air transport allocation key*. As per Article 6(3)(a)(iv), the *allocation key* for transport services is considered to be a *reliable method*, without reference to the conditions in Article 6(3)(a)(iii).

2314. The definition of the *passenger air transport allocation key* is provided in Annex D Section 7. The effect of the *allocation key* is that Adjusted Revenues are allocated in proportion to the number of available seats on the flights operated by the Covered Group arriving in each Jurisdiction over the course of the Period. This means that it sources Adjusted Revenues by reference to flights operated by the air transport Covered Group. To do otherwise would require more complex rules to be designed specifically to take into account code-sharing and interlining (i.e. where a ticket may be issued in the name of one airline but actually operated by another). That approach would also result in Adjusted Revenues being allocated to Jurisdictions where the airline does not or may not be legally permitted to fly.

2315. The proportion is determined as:

- 1) The available passenger capacity of a Covered Group in a Period arriving to a Jurisdiction; divided by
- 2) The available passenger capacity of the Covered Group in a Period arriving to any Jurisdiction.

2316. The *allocation key* uses available passenger capacity (i.e. the number of available seats) as opposed to actual seats filled. This is because passenger capacity for air transport is readily available and verified by tax administrations because it is published. It is also a reasonable indication of the actual number of passengers transported in the airline industry given the commercial need to operate close to capacity.

2317. The Jurisdiction of arrival means the place where passengers disembark. Where there is more than one airport in a Jurisdiction, meaning there is more than one place where passengers disembark in a Jurisdiction, the *allocation key* is applied aggregating the results from each place of landing in that Jurisdiction. It should also be noted that a flight could have more than one Jurisdiction of arrival. For example, if an aircraft operates from Istanbul to Johannesburg (where some passengers disembark) and

then continues to fly to Maputo (where the remaining passengers disembark), both South Africa and Mozambique will be considered Jurisdictions of arrival for purposes of the rules.

2318. As the *allocation key* is based on actual information about how the air transport Covered Group has operated, there is no need for the knock-out rule which applies in respect of other *allocation keys*.

Box 55. Example – Passenger air transport allocation key

The following example illustrates the application of the *passenger air transport allocation key*.

Airline's consolidated financial statements for Period	
Passenger air transport Adjusted Revenues	EUR 20 billion
Airline's Operation Statistics for Period Worldwide	
Available seats arriving in any Jurisdiction	1 billion
Airline's Operation Statistics for Period for Jurisdiction X	
Available seats arriving in Jurisdiction X	10 million

Passenger air transport Adjusted Revenues derived from Jurisdiction X:

- $(\text{Passenger air transport Adjusted Revenues}) \times (\text{Available seats arriving in Jurisdiction X} / \text{Available seats worldwide})$
- $(\text{EUR 20 billion}) \times (10 \text{ million} / 1 \text{ billion}) = \text{EUR 200 million}$

Indicators – Passenger air transport services

2319. There may be some Covered Groups that prefer to use another *reliable indicator* to identify the Jurisdiction where passengers disembark. This is provided for in Article 6(3)(b)(i). Using another *reliable indicator* would require the Covered Group to tie the Adjusted Revenues received for flights to the respective Jurisdictions where passengers disembark.

Box 56. Example – Another reliable indicator: passenger air transport services

The following example illustrates the principles of another *reliable indicator* in the context of passenger air transport services:

The Covered Group operates an airline in region A and operates flights between Jurisdictions X, Y and Z. It received EUR 85 million in Adjusted Revenues for flights sold on its routes. In order to support its

growth strategy, it tracks the Adjusted Revenues it earns by reference to places of origin and destination. Because this information is consistent with the sourcing rule (which is the Jurisdiction where passengers disembark), and is relied on for commercial purposes, it can be used as another *reliable indicator* under Article 6(3)(b)(i).

2320. Under Article 6(3)(b)(ii), a Covered Group may also use an alternative *reliable indicator* to source Adjusted Revenues from passenger air transport services. Any Covered Group wishing to take this approach must demonstrate that the alternative *reliable indicator* produces results that are consistent with the sourcing rule, i.e., that it allocates Adjusted Revenues to Jurisdictions where passengers disembark (as required by Article 6(3)(b)) and that it is reliable (as required by Article 6(3)(b)(ii)(A)). As the sourcing rule does not provide for enumerated *reliable indicators*, the requirement to explain why an alternative *reliable indicator* was used instead of an enumerated *reliable indicator* would be treated as automatically satisfied.

Overview – Cargo air transport services

2321. Cargo air transport services means both (i) services for carrying cargo from one location to another by air; and (ii) connected ancillary services. Typical examples of such connected ancillary services include storage, handling, packing / consolidating, terminal services and Adjusted Revenues from code-share arrangements and ancillary maintenance services provided to other airlines. These are the services that would not be provided by the transport Covered Group in the absence of providing the cargo transport Service itself, and which are ancillary to the provision of the cargo transport services (whether the cargo transport services connected to a given ancillary service are provided by the Covered Group itself, or by other transport providers). This reflects the nature of cargo air transport services, which often include reciprocal provision of services amongst airlines (for example, where one airline has more infrastructure to provide these services in airports in its residence Jurisdiction, and likewise benefits from these services in destination airports provided by other airlines in their Jurisdiction of residence without having to reacquire the necessary infrastructure). Without this rule, it would be expected that the Covered Group could have used the supplementary Adjusted Revenues rule in Article 6(3)(a)(ii) for such Adjusted Revenues, resulting in the treatment of such Adjusted Revenues as cargo air transport services. However, by defining such Adjusted Revenues as always part of cargo air transport services, it simplifies the rule and avoids the necessity of splitting out those Adjusted Revenues and separately applying the supplementary Adjusted Revenues rule.

Sourcing rule – Cargo air transport services

2322. Article 7(1)(d)(vii)(A) states the sourcing rule for cargo air transport services. Adjusted Revenues from cargo air transport services are sourced in equal halves; one half in the Jurisdiction in which the cargo is loaded onto the aircraft; and one half in the Jurisdiction in which the cargo is unloaded from the aircraft. This rule recognises that, unlike a passenger transport service, which is typically a return journey, cargo air transport services are purchased and used on a one-way basis. Therefore, in order to recognise the role of both the origin and destination as a market, each place receives an equal allocation in respect of each flight operated. As for passenger air transport services, this will include transit stops as well as end destinations given the difficulties airlines have of determining whether a stop is a transit stop or a final destination for cargo because of the widespread use of code-sharing arrangements and interlining arrangements.

Allocation Key – Cargo air transport services

2323. Annex D Section 3(D)(2)(c) provides that these Adjusted Revenues are sourced using the *cargo air transport allocation key*. As per Article 6(3)(a)(iv), the *allocation key* for transport services is considered to be a *reliable method*, without reference to the conditions in Article 6(3)(a)(iii).

2324. The *cargo air transport allocation key* is defined in Annex D Section 7. The effect of the *allocation key* is that Adjusted Revenues are allocated in proportion to the weight of cargo carried from and to Jurisdictions on flights operated by the Covered Group over the course of the Period. This is measured not by available capacity, but by actual cargo carried. This is to avoid situations where Adjusted Revenues could be sourced to destinations even though little or no cargo was carried (and so little or no Adjusted Revenues were actually earned from carrying cargo on that flight).

2325. The proportion is determined as:

- 1) 50 per cent of the sum of the cargo weight loaded by a Covered Group onto aircraft in a Period from a place of take-off in a Jurisdiction and the cargo weight unloaded by a Covered Group from aircraft in a Period to a place of landing in the Jurisdiction; divided by
- 2) The sum of the cargo weight loaded by a Covered Group onto aircraft in a Period in all Jurisdictions.

2326. The place of take-off means the Jurisdiction where cargo is loaded onto the aircraft and the place of landing means the Jurisdiction where cargo is unloaded from the aircraft. As for passenger transport services, where there is more than one place of landing in a Jurisdiction, the *allocation key* is applied aggregating the results from each place of landing in that Jurisdiction. As the *allocation key* is based on actual information about how the air transport Covered Group has operated, there is no need for the knock-out rule which applies in respect of other *allocation keys*.

Box 57. Example – Cargo air transport allocation key

The following example illustrates the application of the *cargo air transport allocation key*.

Airline's consolidated financial statements for Period	
Cargo air transport Adjusted Revenues	EUR 20 billion
Airline's Operation Statistics for Period Worldwide	
Total cargo weight carried worldwide	400,000 tonnes
Airline's Operation Statistics for Period for Jurisdiction X	
Cargo weight uploaded from Jurisdiction X	50,000 tonnes
Cargo weight unloaded in Jurisdiction X	30,000 tonnes
Total cargo weight for Jurisdiction X	80,000 tonnes

Cargo air transport Adjusted Revenues derived from Jurisdiction X:

Step 1: determine amount applying the formula

- Cargo air transport Adjusted Revenues x (Total cargo weight uploaded and unloaded in Jurisdiction X / Total cargo weight carried worldwide)
- EUR 20 billion x (80,000 / 400,000) = EUR 4 billion

Step 2: apply 50 per cent allocation

- 50 per cent x amount determined applying *cargo air transport allocation key*
- 50 per cent x EUR 4 billion = EUR 2 billion

Indicators – Cargo air transport services

2327. There may be some Covered Groups that prefer to use another *reliable indicator* to identify the Jurisdictions of the place of loading and place of unloading. This is facilitated by Article 6(3)(b)(i). Using another *reliable indicator* would require the Covered Group to tie the Adjusted Revenues received for cargo transport services to the respective places of loading and places of unloading.

Box 58. Example – Another reliable indicator: cargo air transport services

The following example illustrates the principles of another *reliable indicator* in the context of cargo air transport services:

The Covered Group operates an air freight transport service in region A and transports cargo by air between Jurisdictions X, Y and Z. It received EUR 105 million in Adjusted Revenues for cargo air transport services. In order to support its growth strategy, it tracks the Adjusted Revenues it earns from these services by reference to origin and destination. Because this information is consistent with the sourcing rule (which is the Jurisdiction in which cargo is loaded onto the aircraft and the Jurisdiction in which cargo is unloaded from the aircraft), and is relied on for commercial purposes, it can be used as another *reliable indicator* under Article 6

2328. Under Article 6(3)(b)(ii), a Covered Group may also use an alternative *reliable indicator* to source Adjusted Revenues from cargo air transport services. Any Covered Group wishing to take this approach must demonstrate that the alternative *reliable indicator* produces results that are consistent with the sourcing rule, i.e., that it allocates Adjusted Revenues to the Jurisdiction in which cargo is loaded onto the aircraft and unloaded from the aircraft (as required by Article 6(3)(b)) and that it is reliable (as required by Article 6(3)(b)(ii)(A)). As the sourcing rule does not provide for enumerated indicators, the requirement to explain why an alternative *reliable indicator* was used instead of an enumerated *reliable indicator* would be treated as automatically satisfied.

Overview – Passenger non-air transport services

2329. The structure and principles for sourcing non-air transport services are the same as for air transport services. However, the rules are provided separately because there are specific definitions needed to apply the rules.

2330. Passenger non-air transport services includes both (i) services for carrying passengers from one location to another; and (ii) connected ancillary services. The connected ancillary services would typically include sales of food and duty free consumer goods, entertainment, slot-chartering, as well as advertising displayed on-board. These are services that would not be provided by the transport group in the absence of providing the passenger transport service itself, and which are ancillary to the provision of the passenger transport services and these other Adjusted Revenues are sourced using the same *passenger non-air transport allocation key*. Without this rule, it would be expected that the Covered Group could have used the supplementary Adjusted Revenues rule in Article 6(3)(a)(ii), resulting in the treatment of such Adjusted Revenues as passenger non-air transport services. However, by including such Adjusted Revenues as always part of passenger non-air transport services, it simplifies the rule and avoids the necessity of splitting out those Adjusted Revenues and separately applying the supplementary Adjusted Revenues rule.

Sourcing rule – Passenger non-air transport services

2331. Article 7(1)(d)(vi)(B) states the sourcing rule, which is to source to the Jurisdiction in which the passengers disembark from the vehicle or vessel.

2332. The sourcing rule provides two further details: first, that it is the Jurisdiction where passengers disembark from the vessel provided by or on behalf of the Covered Group. This means that it includes the place where a passenger disembarks the Covered Group's vessel or another vessel operated by a service provider on behalf of the Covered Group (for example, where a separate enterprise is engaged by the Covered Group to operate a vessel to take passengers from a cruise ship docked in the ocean to the port). Second, the sourcing rule provides that a Jurisdiction where a passenger disembarks does not include transit stops. This means that no Adjusted Revenues are sourced to transit stops. Transit stops means an intermediate place where the passenger disembarks, but where this is for the purpose of facilitating their onward transport.

2333. Intermediate destinations are regarded as a transit stop (and therefore not a place where passengers disembark) where the stop is scheduled to be for less than 24 hours. If the stop is scheduled to last for 24 hours or more, it is regarded as a place where passengers disembark to which Adjusted Revenues would be sourced, in equal portions (see example below). This addresses the situations where an important part of the non-air passenger transport service is the inclusion of these other destinations as part of the journey (such as in cruise lines) and which should be recognised as a market in such cases. In such cases, the Adjusted Revenues would be split equally between the places of destination, recognising that any other apportionment measure (such as based on relative duration of stay in a destination) would introduce significant complexity.

Allocation Key – Passenger non-air transport services

2334. Annex D Section 3(D)(2)(b) provides that such Adjusted Revenues are sourced using the *passenger non-air transport allocation key*. As per Article 6(3)(a)(iv), the *allocation key* for transport services is considered to be a *reliable method*, without reference to the conditions in Article 6(3)(a)(iii).

2335. The *passenger non-air transport allocation key* is defined in Annex D Section 7. The effect of the *allocation key* is that Adjusted Revenues are allocated in proportion to the number of passengers

transported on voyages operated by the Covered Group arriving in each Jurisdiction over the course of the Period.

2336. The proportion is determined as:

- 1) The number of passengers transported by a Covered Group in a Period to a destination in a Jurisdiction; divided by
- 2) The number of passengers transported by the Covered Group in a Period to a destination in any Jurisdiction.

2337. Place of destination means any Jurisdiction where passengers disembark the vehicle or vessel provided by or on behalf of the Covered Group but does not include transit stops. The *allocation key* uses actual passenger numbers, rather than available passenger capacity which is used for air transport. This is because actual passenger numbers are understood to be readily available to non-air transport carriers. Where there is more than one place of destination in a Jurisdiction, the *allocation key* is applied aggregating the results from each place of destination in that Jurisdiction. As the *allocation key* is based on actual information about how the transport Group has operated, there is no need for the knock-out rule which applies in respect of other *allocation keys*.

Box 59. Example – Passenger non-air transport allocation key

The following example illustrates the application of the *passenger non-air transport allocation key*.

CruiseCo operates a cruise in region A. The Cruise starts from and finishes in Jurisdiction L and visits Jurisdictions M, N, O and P, spending 36 hours in each of Jurisdictions N and O and less than 24 hours in each of Jurisdictions M and P.

Under the rule, Jurisdiction L will be treated as a place of destination (as that is where the cruises finish and is the final destination) and Jurisdictions N and O will be treated as places of destination as the cruise stops there for 24 hours or more. Jurisdictions M and P are considered transit stops as the cruises stop there for less than 24 hours.

The ships that service region A carried 5 million passengers in the Period.

Cruise Co's consolidated financial statements for Period	
Passenger non-air transport Adjusted Revenues	EUR 20 billion
Cruise Co's Operation Statistics for Period Worldwide	
Passengers transported to destinations in L	6 million
Passengers transported to destinations in M	0
Passengers transported to destinations in N	4 million
Passengers transported to destinations in O	5 million

Passengers transported to destinations in P	0
Passengers transported to destinations on cruise voyages worldwide	15 million
Cruise Co's Operation Statistics for Period for Jurisdiction L	
Passengers transported to Jurisdiction L	6 million

Passenger non-air transport Adjusted Revenues derived from Jurisdiction L:

- $(\text{Passenger non-air transport Adjusted Revenues}) \times (\text{Passengers transported to Jurisdiction L} / \text{Passengers transported to destinations worldwide})$
- $(\text{EUR 20 billion}) \times (6,000,000 / 15,000,000) = \text{EUR 8 billion}$

Indicators – Passenger non-air transport services

2338. There may be some Covered Groups that prefer to use another *reliable indicator* to identify the Jurisdiction of the place of destination. This is facilitated by Article 6(3)(b)(i). Using another *reliable indicator* would require the Covered Group to tie the Adjusted Revenues received for passenger non-air transport services to their respective places of destination.

2339. Under Article 6(3)(b)(ii), a Covered Group may also use an alternative *reliable indicator* to source Adjusted Revenues from passenger non-air transport services. Any Covered Group wishing to take this approach must demonstrate that the alternative *reliable indicator* produces results that are consistent with the sourcing rule, i.e., that it allocates Adjusted Revenues to Jurisdictions of Jurisdictions where passengers disembark (as required by Article 6(3)(b)) and that it is reliable (as required by Article 6(3)(b)(ii)(A)). As the sourcing rule does not provide for enumerated indicators, the requirement to explain why an alternative *reliable indicator* was used instead of an enumerated *reliable indicator* would be treated as automatically satisfied.

Overview – Cargo non-air transport services

2340. Cargo non-air transport services means both (i) services for carrying cargo from one location to another; and (ii) connected ancillary services. Typical examples of such connected ancillary services include fees for late return of containers storage, handling, packing / consolidating, slot-chartering, terminal / port services. These are services that would not be provided by the transport Covered Group in the absence of providing cargo services itself, and which are ancillary to the provision of cargo services (whether the cargo services connected to a given ancillary service are provided by the Covered Group itself, or by other transport providers). Without this rule, it would be expected that the Covered Group could have used the supplementary Adjusted Revenues rule in Article 6(3)(a)(ii), resulting in the treatment of such Adjusted Revenues as cargo non-air transport services. However, by including such Adjusted Revenues as always part of cargo non-air transport services, it simplifies the rule and avoids the necessity of splitting out those Adjusted Revenues and separately applying Supplementary Adjusted Revenues rule.

2341. Cargo non-air transport services also includes a transport service involving the carrying of cargo by both air and non-air, where such services are not separately charged to the customer. This would be

the case, for example, for a Covered Group providing international courier services, where that Group takes the cargo both by air and by road transport, and where the invoice to the customer is for the delivery without specifying whether and in what proportions the delivery will take place by air or road. These are treated as non-air transport services, rather than air transport services, with the difference in outcome being that transit stops are not treated as places of destination in the *allocation key*. This is appropriate in this case, given that the same Covered Group is operating multiple modes of transport but providing one service to the customer for an overall delivery outcome, and where otherwise treating each stop as a place of destination could give rise to distortions depending on the different route that the Covered Group might take with respect to different cargo. Further, as noted in paragraph 2322, the rules for passenger air transport services and cargo air transport services do not distinguish transit stops as in practice for airlines making such a distinction would not be feasible, given the widespread use of code-sharing and interlining arrangements. A Covered Group that provides a transport service partially by air and partially not by air should not experience the same practical challenges.

Sourcing rule – Cargo non-air transport services

2342. Article 7(1)(d)(vii)(B) states the sourcing rule for cargo non-air transport services. Adjusted Revenues from cargo non-air transport services are sourced in equal halves; one half in the Jurisdiction in which the cargo is loaded onto the vehicle or vessel; and one half in the Jurisdiction in which the cargo is unloaded from the vehicle or vessel. This rule recognises that, unlike passenger transport services which typically involve a return journey, cargo non-air transport services are purchased and used on a one-way basis. Therefore, in order to recognise the role of both the origin and destination as a market, each place receives an equal allocation in respect of each journey operated.

2343. In addition, the Jurisdiction in which cargo is loaded or unloaded for cargo non-air transport services does not include transit stops. This recognises that a vessel will often make multiple stops on one journey. For example, in the context of international shipping, stops may be made for offloading to other ships (“transshipment container discharge”) or offloading to that destination (“destination container discharge”), and a single container could be transported on several different ships to get from Port A to Port B. As noted in the introduction to the rules of transport services, the Adjusted Revenues are sourced based on the service the customer has engaged the Covered Group for. Where the customer has paid for the container to be delivered from Port A to Port B, any intermediate transit stops are disregarded; otherwise an allocation that took those stops into account would allocate to Jurisdictions for which the Adjusted Revenues were not earned. This also means that even if part of the cargo non-air transport service was outsourced to a third party, the place of origin and place of destination remains unchanged. The rules look to the place where the cargo is loaded or unloaded by or on behalf of the Covered Group. It should be noted that intermediate transit stops for cargo non-air transport are disregarded irrespective of their duration. This is different to the approach taken for passenger non-air transport, where intermediate transit stops are only disregarded if they are scheduled for less than 24 hours.

Allocation Key – Cargo non-air transport services

2344. Annex D Section 3(D)(2)(d) provides that these Adjusted Revenues are sourced using the *cargo non-air transport allocation key*. As per Article 6(3)(a)(iv), the *allocation key* for transport services is considered to be a *reliable method*, without reference to the conditions in Article 6(3)(a)(iii).

2345. The *cargo non-air transport allocation key* is defined in Annex D Section 7. The effect of the *allocation key* is that Adjusted Revenues are allocated in proportion to the share of cargo carried from and to Jurisdictions on vessels operated by the Covered Group over the course of the Period. This is measured not by available capacity, but by actual cargo carried. This is to avoid situations where Adjusted Revenues

could be sourced to destinations even though little or no cargo was carried (and so little or no Adjusted Revenues were actually earned from operating that journey).

2346. The proportion is determined as:

- 1) 50 per cent of the sum of the volume or weight (as the case may be) of cargo transported by the Covered Group in a Period from a place of origin in a Jurisdiction and the volume or weight (as the case may be) of cargo transported by a Covered Group in a Period to a place of destination in a Jurisdiction; divided by
- 2) The sum of the volume or weight (as the case may be) of cargo transported by the Covered Group in a Period in all Jurisdictions.

2347. The most relevant terminology for measuring the volume or weight of cargo carried varies according to the type of cargo. For example:

- for bulk carriers, oil tankers and chemical tankers and gas tankers, volume is measured in metric tonnes;
- for liner shipping the volume of cargo is measured based on the volume of containers carried (typically measured in Twenty-Foot Equivalent Units, or TEUs), and the volume of empty containers carried should be excluded from the volume of containers carried;
- for roll-on/roll-off (RoRo) ships the volume is measured in lane metres;
- for car carriers the volume is measured in Car Equivalent Units;
- for passenger roll-on/roll-off (RoPax) ships the volume is measured in lane metres plus total number of passengers.

2348. As for passenger transport services, where there is more than one place of landing in a Jurisdiction, the *allocation key* is applied aggregating the results from each place of landing in that Jurisdiction. As the *allocation key* is based on actual information about how the air transport Group has operated, there is no need for the knock-out rule which applies in respect of other *allocation keys*.

Box 60. Example – Cargo non-air transport allocation key

The following example illustrates the application of the *cargo non-air transport allocation key*.

ShipCo's consolidated financial statements 2023	
Cargo non-air transport Adjusted Revenues	EUR 40 billion
ShipCo's Operation Statistics 2023 Worldwide	
TEUs transported worldwide	20,000,000
ShipCo's Operation Statistics 2023 Jurisdiction X	

TEUs uploaded in Jurisdiction X	100,000
TEUs unloaded in Jurisdiction X	40,000
Total TEUs for Jurisdiction X	140,000

Cargo non-air transport Adjusted Revenues derived from Jurisdiction X:

Step 1: determine amount applying the formula Cargo

- Adjusted Revenues x (TEUs uploaded and unloaded in Jurisdiction X / TEUs transported worldwide)
- EUR 40 billion x (140,000 / 20,000,000) = EUR 280 million

Step 2: apply 50 per cent allocation

- 50 per cent x amount determined applying formula
- 50 per cent x EUR 280 million = EUR 140 million

Indicators – Cargo non-air transport services

2349. There may be some Covered Groups that prefer to use another *reliable indicator* to identify the Jurisdictions of the place of origin and place of destination. This is facilitated by Article 6(3)(b)(i). Using another *reliable indicator* would require the Covered Group to tie the Adjusted Revenues received for cargo non-air transport services to the respective places of origin and places of destination.

Box 61. Example – Another reliable indicator: cargo non-air transport services

The following example illustrates the principles of another *reliable indicator* in the context of cargo non-air transport services:

The Covered Group is an international courier group. It transports packages internationally for consumers and businesses and charges customers per package. The pricing system is based on a range of factors including weight, volume, distance, whether the origin and destination is a hub for the Covered Group and speed of delivery (with this final factor having a significant impact on price charged to the customer and therefore the amount of Adjusted Revenues earned by the Covered Group). When billing customers, the Covered Group issues an invoice that includes details on the place of origin, the place of destination and the price. Because this information is consistent with the sourcing rule (which is the Places of Origin and places of destination), and is relied on for commercial purposes, it can be used as another *reliable indicator* under Article 6(3)(b)(i).

2350. Under Article 6(3)(b)(ii), a Covered Group may also use an alternative *reliable indicator* to source Adjusted Revenues from cargo non-air transport services.

E – Customer reward programs

Overview

2351. Article 7(1)(d)(viii) and Annex D Section 3(E) provide the revenue sourcing rules for customer reward programs. This means Adjusted Revenues generated from the operation of a customer reward program, other than Adjusted Revenues generated from the redemption of awarded units for goods or services provided by the Covered Group (such as when the reward program points are redeemed in exchange for an air ticket or nights in a hotel).

2352. Customer reward program means marketing programs designed to win customer loyalty by awarding units to a customer which may be redeemed for other goods and services and includes such marketing programs where the Covered Group sells units to third party business customers for award to mutual customers. Certain Covered Groups, such as airlines, hotels or credit card companies, operate customer reward programs. Customer reward programs typically operate as follows:

- The Covered Group offers rewards points to its loyalty members in connection with the customer's spending on its products / services.
- The Covered Group also sells points to other partnering businesses, such as other airlines, hotels or retailers, who then issue those points to their customers.
- In general, Adjusted Revenues are not recognised when the points are given to the loyalty member or sold to the partner business, but are recognised when the member redeems those points for a good or service (such as a flight or consumer product).
- A small portion of the Adjusted Revenues may be recognised based on an estimate of the points that will expire or will not be redeemed.

- In the case of airlines, if the member redeems points for an air product, then these Adjusted Revenues are recognised under Adjusted Revenues from passenger transport services, as this is seen as just an alternative method of payment for the airfare. These Adjusted Revenues would be sourced under air transport services, above. The same could be true of hotels, and these Adjusted Revenues which would be sourced similarly to *location-specific services* above.
- If the member redeems points for a product other than one provided by the Covered Group, then these Adjusted Revenues are dealt with under this rule for customer reward programs.

Sourcing rule

2353. Article 7(1)(d)(viii) states the sourcing rule, which is to source to the Jurisdiction in proportion to the number of members located in each Jurisdiction that have redeemed or earned one or more units during the Period. A person is located in the place where they are habitually located. Although Adjusted Revenues from customer reward programs are received from other businesses (such as other airlines, banks and retailers), it would not be generated without the customers that are members of the program and typically is recognised when the customer redeems their points. In this respect, the nature of the *transaction* is similar to online advertising services, where the Adjusted Revenues are received from advertisers (other businesses) but understood to be generated from (and therefore sourced to) the viewers of the adverts. The Covered Group providing advertising services targets the viewers and, in a similar way, the customer reward program is designed to target the active members. Given the Adjusted Revenues generated from the redemption of the points will generally reflect spending on items such as consumer products, which will usually be where the customer lives, it is appropriate to source these Adjusted Revenues to that Jurisdiction, rather than globally based on the other activities of the Covered Group, such as the flights operated.

2354. However, in a similar way as for Adjusted Revenues from passenger transport services, Adjusted Revenues received from the business partner for the purchase of points is not traceable by reference to the subsequent individual redemption of points for goods or services. This is because the customer will have earned the points from its spending with the unrelated partner business, meaning that the Covered Group cannot identify how those points were earned by the customer in order to tie that to the Adjusted Revenues earned from the partner business. This means that it is not practicable to source based on individual *transactions*, but rather, a more aggregated approach is required. This approach is provided in paragraph 1, and allocates Adjusted Revenues from customer reward programs in proportion to the population of active members of the customer reward program in each Jurisdiction. Active member means a member of the program that has redeemed or earned units during the Period. This means that a large number of dormant members will not affect the allocation for the Period.

2355. Annex D Section 3(E)(1) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from customer rewards programs.

Indicators

2356. Although Article 7(1)(d)(viii) provides an aggregated approach, the data to operate that key is based on indicators. The indicators (included in Annex D Section 3(E)(2)) are the user profile information, billing address or place of the international dialling code associated with the telephone number of the active members. Alternatively, as per the definition of *reliable indicator* in Article 6, another *reliable indicator* or an alternative *reliable indicator* may be used.

Box 62. Example – Customer reward program allocation

The following example illustrates the application of the allocation for customer reward programs.

The Covered Group is an airline, and earns Adjusted Revenues from customer reward programs. The Adjusted Revenues are EUR 500 million for the Period.

The Covered Group determines, based on *reliable indicators*, that it has active members located in the following Jurisdictions, in these proportions:

- Jurisdiction A: 85 per cent
- Jurisdiction B: 10 per cent
- Jurisdiction C: 5 per cent

Revenues are sourced as follows:

- Jurisdiction A: 85 per cent x 500m = 425m
- Jurisdiction B: 10 per cent x 500m = 50m
- Jurisdiction C: 5 per cent x 500m = 25m

F – Other services

Overview – Other services and digital content

2357. Article 7(1)(d)(ix) and Annex D Section 3(F) provide the revenue sourcing rules for any other type of service not specifically covered in Article 7(1)(d)(i) through (viii). In practice, this would be expected to cover B2C services (such as education and personal advisory services, as well as digital services such as streaming and gaming). It would also be expected to cover B2B services (such as cloud computing, electronic payment services, telecommunications services other than those provided to a fixed location, and consulting services). This category is referred to as “other services”. In addition, the rule for digital content (such as software) in Article 7(1)(b) redirects to this sourcing rule.

2358. It also includes the provision of financing. Financing (which is in this case the lending of money) may in many cases be covered by the exclusion for regulated financial services. However, certain businesses may not fall within the exclusion, but derive Adjusted Revenues from financing (such as interest income). This would include providing financing to a customer to purchase the Covered Group’s finished goods or services.

2359. No formal distinction is made in the sourcing rule as between consumers or business recipients of the service. This recognises that it may not be apparent whether a purchaser of a service is a consumer or business (e.g. where consumers as well as businesses may purchase cloud services, or where an individual acquires a cloud product but for use in its own small business). However, the approach to

applying the sourcing rule takes into account that the customers may be individuals, which would be expected to be smaller customers as explained below.

2360. The rules in Annex D Section 3(F) also contain provisions to provide revenue sourcing rules for business models where a service is sold to a customer who is a reseller. The same sourcing principle applies as for independent distributors of finished goods, which requires looking through to the place of use of the service by the final customer.

2361. Reseller means a business customer that buys a service subject to the condition that the service is solely for onward distribution or resale to third parties. The term reseller does not include a business customer that acquires a service as an input to facilitate the provision of a different service to a third party. That means that the reseller rule does not apply to cases where a Covered Group sells a service, part of which will be bundled with the customer's own service (e.g. where the Covered Group provides a cloud service to its customer, which in turn offers a consultancy service to its own customers which, among other things, includes the provision of the Covered Group's cloud service). The Covered Group can assume that services sold for onward sale will not be bundled with the customer's own services unless it has actual knowledge that indicates otherwise. Where the Covered Group knows that its service will be bundled with its customers own services and is therefore in the nature of an input, the services are treated as other services sold by the Covered Group directly. In other words, a reseller operates under pure distribution arrangements, whether they are referred to by the Covered Group as resellers or distributors, and whether the immediate acquirer of the service will sell to the final customer or to another reseller or distributor. The reseller itself will not be a final customer.

2362. The rules in Article 7(1)(d)(ix) and Annex D Section 3(F) are also used to source Adjusted Revenues from digital content, other than where otherwise covered by the rules for components. Digital content means content that is provided by digital means. This is to be broadly interpreted and to capture all types of digital content. It includes, but is not limited to music, books, videos, text, games, applications, computer programmes, software, online newspapers, online libraries and online databases, where such items are provided in digital format or accessed over the internet. An item can be digital content whether it can only be accessed once, can be accessed in perpetuity or can only be accessed for a limited period. Some of these items will have a non-digital equivalent, such as physical books or music on a CD. Such items, not being provided in digital format or accessed over the internet but in physical form, are categorised as finished goods.

2363. Digital content that is a component is expressly carved-out from Article 7(1)(b) and is sourced as a component. An example of digital content that is a component is software that is sold by a Covered Group to an original equipment manufacturer which is then installed onto a laptop prior to being sold to the final customer. This ensures that Adjusted Revenues from such sales are sourced to the location of the final customer of the finished Good, i.e., to the Jurisdiction of delivery to final customer of the laptop. Note that this would be different to software sold by a Covered Group to a customer who then uses the software by installing it on their laptop. Even though the software is for incorporation into another good, the software was not sold to a business customer for incorporation into another product which his then for sale.

2364. There may be a question as to the distinction between digital content and *intangible property*, particularly in connection with computer programs. In some Jurisdictions the right to use a computer program might be treated as *intangible property* because to use the program, it must be copied onto the user's computer. However, where the right to copy the program is limited in such a way that it does no more than enable the effective operation of the program by the user, the Adjusted Revenues should be categorised based on their ordinary character which is digital content. A similar analysis would apply where Adjusted Revenues are earned from selling software to a large business where the customer obtains rights to make multiple copies of the program for operation within its own business (sometimes referred to as

'site licences', 'enterprise licences' or 'network licences'). As the rights to copy the program again are limited to what is required to enable the operation of the program on the customer's computers or network, the ordinary character of the *transaction* would prevail, and it would be regarded as a provision of digital content. Similarly, if a purchaser of software is permitted to make limited modifications to software to configure it into its existing system, the ordinary character of the *transaction* would prevail and it would be regarded as a provision of digital content (as the rights to modify the program are limited to what is required to enable the operation of the program on the customer's computers or network).

2365. Further, arrangements between a software publisher and a reseller may often include rights in favour of the reseller to distribute copies of computer programs without rights to reproduce those programs. Under these arrangements, the rights acquired by the reseller are limited to those necessary for the reseller to distribute copies of the software and the distributors are paying for the acquisition of the software copies and not to exploit any right in the software copyright. In those cases, the ordinary character of the Adjusted Revenues would determine that they should be categorised as digital content sold through a reseller.

2366. By contrast, Adjusted Revenues received for the rights to use copyright in software, i.e., the rights to reproduce and distribute the software or to modify it and make derivative works, would be regarded as Adjusted Revenues from *intangible property* (see also discussion in paragraph 2428 for the meaning of *intangible property*). Broadly, it is intended that for purposes of the Convention, the right to use a computer program (rather than the copyright in a computer program) should be treated as a digital content (when sold as the final product) or a component (when included as an element of another good for sale, such as software pre-installed on another Covered Group's laptops) and sourced in the same way as services or components irrespective of domestic law characterisation.

2367. Finally, there may be cases where one Covered Group providing the same offering through different means could have Adjusted Revenues from different categories. For example, a music streaming service that offers a subscription-based service would be digital content. However, that same music streaming service provider may also offer a free service, which comes with advertising. In that case, the Adjusted Revenues from the free streaming service offering are received not from the subscribers but from advertisers, and the Adjusted Revenues are from advertising (while the Adjusted Revenues from the subscription service continue to be categorised as digital content).

Sourcing rule

2368. Article 7(1)(d)(ix) states the sourcing principle which is the Jurisdiction in which the service is used. Customer means a person who acquires the services from the Covered Group in the ordinary course of trade of the Covered Group, and final customer means a person (including a business customer or government) acquiring the service for use, other than as a component. This means that it includes sales made to a business or to an individual consumer, provided that the purchaser is acquiring the service for its own use, and not for resale (which would be the case of a reseller, as discussed below under this section and in respect of which different rules apply) or incorporation into another product for resale (which would be the case of a component, as discussed above). For example, where a Covered Group provides cloud computing services to a streaming platform, the final customer of the cloud computing service is the streaming platform. Where a Covered Group provides software to a department store that resells the software, the department store is not the final customer.

2369. The place of use is a different idea to the place of performance of the service, which would be the primary basis on which traditional way taxation of services takes place. It is also a different idea to the sourcing approach taken for components and *intangible property*. In those cases, the sourcing rule looks to the market Jurisdiction where the final customer ultimately makes use of the component or *intangible property* given that it is an input that is integrated into the final customer's good or service. In the case of

services, the service is better understood as being consumed itself, even if it indirectly supports a production process of another product or service that is then itself separately provided to a final customer (and sourced on that basis).

2370. In some cases, the place of use will be relatively intuitive. For example, an IT service agreement provided to a government agency to administer its social security program would be used in the Jurisdiction of that Government.

2371. However, it is also recognised that in other cases, while there must logically be a place of use in that the services are being used, identifying the specific place(s) may not be without doubt, particularly when the customer is itself a large MNE. For example, in the case of a consulting service provided to assist a large MNE to acquire another large MNE, conceptually there would be a basis for arguing that the place of use is the location of the headquarters of the *acquiring group*; but equally it could be argued that the place of use is better represented by the location of the headquarters of the target group or by the location of each entity that is a member of the target group. Even if there was a way to conceptually agree the place(s) of use, there would be a question about how to identify the proportionate use of the service and the Adjusted Revenues attributable to each where there is more than one location of use. In addition, in other cases where the place of use is conceptually clear, there might be other practical reasons that prevent the supplier from identifying that place of use. For example, if a cloud service is provided to a large MNE, the precise access rights to such services within the business are typically arranged by the customer and the cloud service provider has no visibility thereover, all the more given the use of a VPN is commonplace. As such, there are both conceptual and practical challenges to accurately identifying place of use of these types of services, where the customer is itself a large MNE.

2372. Annex D Section 3(F)(1) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from other services.

2373. The rules in Annex D Section 3(F) make a distinction between other services provided directly by the Covered Group (contained in paragraph 2), as opposed to other services provided by the Covered Group through a reseller (contained in paragraph 3). Each paragraph is discussed in turn.

Indicators – Other services and digital content

2374. The indicators for the place of use of other services or digital content differ depending on whether the services or digital content is provided to a *specified large customer*, or any other customers.

2375. *Specified large customers* are defined as a customer from whom the Covered Group has received EUR 20 million or more in a Period in respect of other services, if it also represents one of the top 200 customers of the Covered Group (assessed by reference to the Adjusted Revenues derived from other services by the Covered Group for the Period). Alternatively, a *specified large customer* is one from whom the Covered Group has derived more than EUR 100 million in a Period in respect of other services (even if the number of those customers exceeds 200). The *specified large customers* do not include large contracts with resellers or distributors of other services. This part of the rules in Annex D Section 3(F)(2) is mutually exclusive with the rules on resellers of other services in Annex D Section 3(F)(3), discussed below.

2376. If the Covered Group had no customers from which it received at least EUR 20 million in a Period in respect of other services, then they do not apply the rule for *specified large customers* (which may be the case, for example, where the Covered Group is providing all of its other services to individuals). On the other hand, if the Covered Group had, for example, 350 customers from which it received more than

EUR 100 million in a Period in respect of other services, then all of those customers would be treated as *specified large customers*.

2377. The *specified large customer* test is assessed looking at each legal entity billed by the Covered Group. This means that it does not require the Covered Group to aggregate Adjusted Revenues derived from customers which are themselves related. At the same time, even if there are separate accounts in respect of each legal entity (for example, if the customer requires separate accounts for separate projects), those accounts must be aggregated to test the size of the customer by reference to the entity. This approach balances the administrative burdens, while also addressing the risk of fragmentation of accounts to intentionally fall below the *specified large customer* definition.

2378. To apply this rule, the Covered Group should identify its *specified large customers* (as explained above). The mechanism for doing so must be documented so that it can be available for review by tax administrations.

2379. For administrative ease and to assist Groups in conducting the manual work required in respect of *specified large customers*, a Covered Group is permitted to elect to identify the *specified large customers* as they were for the prior Period. This means that the Covered Group will know who their *specified large customers* are at the start of the Period. For example, in Period 2, the Covered Group elects to identify its specified large customers based on the Adjusted Revenues earned from other services in respect of Period 1. This election is provided for in the definition of *specified large customer*.

2380. All other customers are treated as smaller customers. In practice, smaller customers would typically include consumers.

2381. Paragraph 2(a)(i) sets out the enumerated indicators in respect of Adjusted Revenues from other services to *specified large customers*. As per the definition of *reliable indicator* in Article 6, another *reliable indicator* or an alternative *reliable indicator* could be used if there is another type of information to source Adjusted Revenues from digital content and other services to *specified large customers*.

2382. These enumerated indicators are information reported by the customer on the place of use; and information contained in contractual or other commercial documentation. Other commercial information could include information obtained in the course of visiting the customer to devise the programme of work and provide implementation support. It is, however, recognised that for many Covered Groups it is not commercial practice for place of use to be recorded in a contract or for customers to provide any reporting on the place of use. This may be because the place of use of the service is conceptually difficult to identify given the nature of the service. It may also be because the information is not required by the Covered Group in order to receive the service, or because such information may be commercially sensitive for the customer to share with its service provider (who in some cases may be a competitor). Whether the contract or provides an indication of the place of use of the service may depend on the nature of the service being provided.

2383. The use of these enumerated indicators is subject to the requirement that they *be reliable indicators* as per Article 6(3)(b)(i). This means that the information must credibly indicate the place of use of the service.

Box 63. Examples – Enumerated indicators for other services to specified large customers

The following examples illustrate the identification of a *reliable indicator* from the contractual or commercial documentation.

Example 1

The Covered Group provides business consulting services to other large businesses. The programme of work outlined in the contract specifies that the consultancy advice is sought in relation to improving the operation of the customer's retail business in Jurisdiction A. The consultancy report is delivered to the senior management located in Jurisdiction A. The information from the contract is a *reliable indicator* of the place of use, which is Jurisdiction A.

Example 2

The Covered Group is providing IT services to a public hospital. The location of the hospital is Jurisdiction D, and this is named in the contract. The information from the contract is a *reliable indicator* of the place of use, which is Jurisdiction D.

Example 3

The Covered Group is providing cloud and IT services to a government agency. The Jurisdiction which established the government agency is a *reliable indicator* of the place of use, which is Jurisdiction D.

2384. Paragraph 2(a)(ii) provides the enumerated indicators through which the Covered Group would source the Adjusted Revenues from other services to all other customers (smaller customers). These are the billing address, the user profile information of the smaller customer or the place of the international dialling code associated with the telephone number of the smaller customer. The billing address should be reliable in these cases, for example, because individuals would typically use the billing address associated with where they are located and most likely using the service. The same is true for small and medium enterprises which are likely to only be located in one Jurisdiction which would be the same as indicated by the billing address. Even for larger customers that may often procure through local subsidiaries, the billing address would be a *reliable indicator* of where the service is being used.

2385. For smaller customers, the place of use is not tested based on every point the customer accesses the digital content, but is assessed as the ordinary place of use. For example, a video streaming service provided to an individual would be considered to be used in the Jurisdiction where the person usually accesses the streaming service. It is accepted that services like streaming services may be used by individuals in more than one Jurisdiction (for example if a person accesses the streaming service while on vacation in another Jurisdiction). However, such temporary and intermittent use in other Jurisdictions is disregarded when determining the place of use of the service for purposes of Article 7(1)(d)(ix), given that such services are likely to be of a more general and enduring nature. It also recognises the difficulty of apportioning Adjusted Revenues based on occasional travel or use of a service other than in the usual place of use. It is for this reason that the billing address is appropriate in the case of smaller customers, as this is likely to represent the location where the customer normally enjoys the digital content. As such, the fact that a customer accesses the product while abroad does not mean that the Covered Group can no longer rely on the billing address.

2386. However, there may be cases where the Covered Group has actual knowledge that the billing address is not the place of use of the service and in those cases, it would not be considered to produce results that are consistent with the sourcing rule and therefore would not meet the definition of *reliable indicators*.

Box 64. Example – Billing address for smaller customers

The following example illustrates the application of this rule.

The Covered Group provides a television streaming service internationally. Customers are typically billed on a monthly basis. When customers first subscribe, they provide their credit card number and billing address. As the billing information is consistent with the sourcing rule (in that it identifies the Jurisdiction where the streaming service is usually used by the customers) and it is relied on for another commercial purpose (to bill the customer), it can be considered a *reliable indicator*.

The Covered Group is conducting a review of customer information, as a means of informing its commercial expansion and marketing strategies. In the course of this review, it has identified that a significant portion of the billing addresses are in the same, very small, Jurisdiction. As the Covered Group does not undertake any marketing or promotional activities in that Jurisdiction, it decides to launch a customer research project to better understand the customer base in that Jurisdiction. That research includes requesting that the customers complete online customer feedback surveys where they provide additional information including confirmation of where they live. It transpires from the customer research that a significant proportion of the customers with billing addresses in that small Jurisdiction in fact live elsewhere. Although the Covered Group is not required to investigate the reliability of every billing address, because it has obtained this information in the course of its business, it must use that information. In this case, the billing addresses where the mismatch has arisen cannot be used as the outcome is not consistent with the sourcing rule and as such the billing address in those cases is not reliable. The Covered Group should take reasonable steps to use either the user profile (if relevant) or the international dialling code associated with the smaller customer's telephone number (if available). The Covered Group could also use another *reliable indicator* or an alternative *reliable indicator*, however, it is not required by the rules to do so. If the Covered Group opts not to use another *reliable indicator* or an alternative *reliable indicator*, and none of the enumerated indicators were reliable, the default *allocation key* provided in Article 6(4) would apply.

2387. As per the definition of *reliable indicator* in Article 6, another *reliable indicator* or an alternative *reliable indicator* could be used if there is another type of information to source Adjusted Revenues from digital content and other services to smaller customers.

2388. The application of another *reliable indicator* is not mandatory, but where the Covered Group has reliable information other than the enumerated indicators listed in paragraph 2(a), it may be able to use it. For example, in the case of smaller customers, this could include geolocation of the device of the consumer through which the purchase of the service is made; or the IP address of the device of the consumer through which the purchase of the service is made, if such information otherwise meets the requirements of Article 6(3)(b)(i).

Box 65. Examples – Another reliable indicator for other services

The following examples illustrate the principles of another *reliable indicator* in the context of digital content and other services.

Example 1

The Covered Group is providing legal services to a business customer. The letter of engagement provides that the services will support the customer acquiring an asset. The acquiring entity is in Jurisdiction A. The asset is in Jurisdiction B. The decision-makers in the business that are responsible for the acquisition are in Jurisdiction C.

The Covered Group cannot determine the proportionate use that is made of the service in each Jurisdiction, but it is clear that the service could only be used in Jurisdictions A, B and/or C. The Covered Group reviews the billing information it has, which is based on time spent by its employees, in order to more accurately identify the place of use (as opposed to performance) of the services. On this basis, the Covered Group can show that the primary part of the services was provided in connection with the risks of the acquisition in Jurisdiction C, which accounted for 75 per cent of the invoice amount. A further 20 per cent was spent providing legal advice on group-wide risks to the decision-makers in Jurisdiction C. The last 5 per cent was spent in connection with the acquiring entity.

This billing information may be used by the Covered Group as another *reliable indicator* under Article 6(3)(b)(i) as it is consistent with the sourcing rule (in that it identifies the place of use of the service), and it is relied on for other commercial purposes (i.e., to demonstrate to the customer how the fees were incurred).

Example 2

The Covered Group is providing online music streaming services, part of which is a subscription based service (the other part of which is provided for free and sourced under online advertising services). For the subscription services, there is a customer on-boarding process. This has been designed to comply with VAT / GST requirements around the world, and it collects three pieces of information from the customer: the user profile as already created in connection with the user's presence on other social media sites; the Jurisdiction of residence; and a credit card. The system has been designed such that the registration cannot be completed if there is not a match between at least two of the location fields (for example, the Jurisdiction information and the location information from the credit card). Based on this information, it creates a user profile labelling the Jurisdiction of the user (on the basis of which it then suggests popular music and concerts in that location). Because this information is consistent with the sourcing rule (which is the place of use of the service), and has been designed for compliance with other regulatory requirements, and has a double confirmation of the location information, it meets the definition of a *reliable indicator* and can be used as another *reliable indicator* under Article 6(3)(b)(i).

Example 3

The Covered Group sells software, in the form of a physical access key which enables the customer to download the software. The software must be activated online using the access key, so that the Covered Group can detect and manage any infringements and so that the customer can access online helpdesk functions. This activation process is mandatory, and so covers all customers. This information can be used as another *reliable indicator* (under Article 6(3)(b)(i)) because it identifies the location where the customer will use the product and is collected for commercial purposes.

Example 4

The Covered Group sells computer games. The games are designed to be played online, with other gamers. In order to play the game, customers need to create a user profile. This includes a credit card number, which provides a country code associated with the issuing bank (but does not include the billing address of the user). This information is needed for commercial purposes, because it allows the Covered Group to detect the location of the user, and direct them to the correct version of the online store for purchasing related items such as in-game additions. Due to licensing restrictions, different content is available in different Jurisdictions, meaning the location of the user is needed to operate the business. This information can be used as another *reliable indicator* (under Article 6(3)(b)(i)) because it identifies the location where the customer will use the product and is collected for commercial purposes.

Example 5

The Covered Group provides a customer relationship management software system to a multinational group, one of its specified large customers. The multinational group uses the software internationally but provides no breakdown to the Covered Group of where the software is used. However, the Covered Group can identify the Jurisdictions where the employees of the multinational group that access the software are located based on IP address, because the customer has not configured the access to the software through one central VPN. The Covered Group uses this information to determine the appropriate staffing levels (taking account of language and time zone) of a helpdesk service that is available to its customers who encounter issues when operating the system. Because the IP address information is consistent with the sourcing rule (in that it indicates the place of use of the service), and is relied on for commercial purposes (to inform the resourcing of the associated helpdesk services), it meets the definition of a *reliable indicator* and can be used as another *reliable indicator* under Article 6(3)(b)(i).

Example 6

The Covered Group provides payment processing services:

- a. to its customers that are *regulated financial institutions* (“RFIs”) that issue payment cards to their customers; and
- b. to its customers that are RFIs that acquire merchants that accept payment cards.

It receives separate remuneration and has a separate legal relationship with each of those customers. The payment processing services involve the Covered Group facilitating authorisation of payments to and from those RFIs in connection with *transactions* entered into by the RFI’s customers (i.e. individual payment card holders), and clearing, settlement and related services to ensure the merchants receive in their bank accounts the payments made to them by payment card holders.

The Covered Group manages relationships with its RFI customers on a Jurisdiction-by-Jurisdiction basis. Even where the Covered Group has a global relationship with an international RFI to provide payment processing services, there is a separate legal relationship with local legal entities within the RFI’s group that accounts for and invoices services provided on a jurisdictional and legal entity basis. As the RFIs are subject to regulation that restricts them to providing their services locally, the place of the use of the payment processing services is the Jurisdiction of the local legal entity.

Those *local entities* are billed for the services provided and as such the billing address is an indicator of the place of use. As the billing address is consistent with the sourcing rule (in that it identifies where

the payment processing service is used by the RFIs) and is relied on for commercial purposes (in that it determines how the legal relationship is managed), it can be treated as a *reliable indicator* as required by Article 6(3)(b)(i). To the extent that the Covered Group's services are provided to *specified large customers*, this will be another *reliable indicator*, given that the billing address is not listed as an enumerated indicator for *specified large customers*. Given that the Covered Group has another *reliable indicator* for its *specified large customers*, it will not need to use the *aggregate headcount allocation key*. Further, if the Covered Group could also use the billing address as a *reliable indicator* in respect of smaller customers, and was therefore using the billing address as its *reliable method* for all of its customers in connection with the Adjusted Revenues from payment processing services, it would not need to separately identify its *specified large customers*.

2389. As for another *reliable indicator*, the application of an alternative *reliable indicator* is not mandatory, but where the Covered Group has reliable information other than the indicators listed in paragraph 2(a), it may be able to use it.

Box 66. Examples – Alternative reliable indicator for other services

The following examples illustrate the principles of an alternative *reliable indicator* in the context of other services.

Example 1

The Covered Group has appointed a relationship manager for its larger customers, and this relationship manager has specific and ongoing responsibility for managing the business relationship, customer satisfaction and overall account for those customers. The relationship manager is familiar with the customer, including the contact details and main place of business operations, structure and strategy. In the course of fulfilling this role, the relationship manager has acquired detailed knowledge about how the customer is using the Covered Group's service. The relationship manager knows that the service is primarily used in the headquarters Jurisdiction, and in two regional headquarters Jurisdictions, which is where most of the strategic planning and management, and IT operations, take place. However, no information is available as to the proportionate use of the service to be made in each Jurisdiction.

The Covered Group proposes to allocate the Adjusted Revenues to each of those three Jurisdictions in proportion to their respective shares of GDP, in line with the *service allocation key*. The Covered Group applies for an *advance certainty review* to use this approach as an alternative *reliable indicator* under Article 6(3)(b)(ii). As such the Covered Group would need to explain the reasons for using this approach rather than using the indicators enumerated in Annex D as required by Article 6(3)(b)(ii)(A). The Covered Group would also need to demonstrate that the approach produced results that were consistent with the sourcing rule and was otherwise reliable. In this respect as the use of GDP to allocate Adjusted Revenues between the identified Jurisdictions is consistent with the *allocation key* (which would otherwise apply), that aspect of the approach would meet the otherwise reliable standard.

Example 2

The Covered Group is providing cloud computing services to a customer. The customer has asked for on-site configuration support to migrate its existing systems over to the cloud computing solution. The customer's existing systems are specific and separate at each of its places of business, which is in

Jurisdictions E, F, G and H, rather than being one central system deployed from headquarters. As such, the contract sets out each location where on-site support is needed. However, no information is available as to the proportionate use of the service to be made in each Jurisdiction. The Adjusted Revenues are allocated to each of Jurisdictions E, F, G and H in proportion to the *service allocation key*. The Covered Group applies for an *advance certainty review* to use this as an alternative *reliable indicator* under Article 6(4)(b)(ii). As such the Covered Group would need to explain the reasons for using this approach rather than using the indicators enumerated in Annex D as required by Article 6(4)(b)(ii)(A). The Covered Group would also need to demonstrate that the approach produced results that were consistent with the sourcing rule as required by Article 6(4)(b) and was otherwise reliable as required by Article 6(4)(b)(ii)(A). In this respect as the use of the *service allocation key* to allocate Adjusted Revenues between Jurisdictions E, F, G and H is consistent with the ordinary rule that would otherwise apply, that aspect of the approach would meet the otherwise reliable standard.

Example 3

The Covered Group is in scope of the Convention by virtue of the exceptional segmentation rule. Because the in-scope segment is treated as dealing with the rest of the Covered Group as if it was a third party, Adjusted Revenues earned by that in-scope segment is also subject to the revenue sourcing rules, including where the customer is another segment. The in-scope segment is providing cloud services to the other segment, and this is one of its *specified large customers*. Given that the seller and the customer are part of the same Group, with the same management and internal information systems, the in-scope segment has reliable information on the entities in the Covered Group which are using the cloud service, which are located in three different Jurisdictions. However, it does not have reliable information on the proportion of use of the cloud, because this is not possible to trace. The Adjusted Revenues are allocated to each of those three Jurisdictions in proportion to the actual headcount of each entity. The Covered Group applies for an *advance certainty review* to use this as an alternative *reliable indicator* under Article 6(3)(b)(ii). As such the Covered Group would need to explain the reasons for using this approach rather than using the indicators enumerated in Annex D as required by Article 6(3)(b)(ii)(A). The Covered Group would also need to demonstrate that the approach produced results that were consistent with the sourcing rule as required by Article 6(3)(b) and was otherwise reliable as required by Article 6(3)(b)(ii)(A). In this respect as the use of headcount data is otherwise consistent with the concept of the ordinary rule that would apply for *specified large customers*, that aspect of the approach would meet the otherwise reliable standard.

Allocation key – Other services

2390. Annex D Section 3(F)(2)(b) provides for an *allocation key* in case there are Adjusted Revenues from other services sold to *specified large customers* for which enumerated indicators as included in paragraph 2(a) are not available (i.e. because they do not exist in the information reported to the Covered Group or in the contractual or commercial documentation, or where any such information is not reliable) and the Covered Group chose not to use another *reliable indicator* or alternative *reliable indicator*.

2391. The *allocation key* in this respect is the *aggregate headcount allocation key*. This is a defined term and is further explained below.

2392. As the *aggregate headcount allocation key* is an *allocation key* within the meaning of Article 6(3)(c), the prerequisites for it to be a *reliable method* in accordance with Article 6(3)(a)(iii) are that the use of the *allocation key* is expressly permitted in the rule (which is the case for this rule); that the Covered Group demonstrates that it has taken reasonable steps to identify an enumerated indicator and concluded that

no such *reliable indicator* is available; and that the knock-out rule is applied. The latter two are discussed in turn.

2393. Reasonable steps are included in the rule to ensure that, insofar as practical, reliable information is obtained. The Covered Group is expected to use information that is available to it and that can feasibly be used to identify the Jurisdiction of use of the service. For example, if a Covered Group selling services to a *specified large customer* did obtain some reliable information on the location of use of the service, this should be used, even if it does not cover all sales.

2394. However, it is expected to be challenging to accurately trace the place of use of other services to *specified large customers*. Therefore, the expectation of reasonable steps must be proportionate and take account of the costs and likely benefits.

2395. The reasonable steps to identify enumerated indicators mean, in this context, that the Covered Group must determine whether information is reported by the customer to the Covered Group on the place of use of the services, and review the information contained in the contract as well as any other commercial documentation (such as information required to be shared with the Covered Group under the contract, or documentation in connection with after-sales services provided in connection with the use of the services) to determine whether any reliable information on the place of use is in its possession. In most cases this will require a manual review of those contracts. However, it does not require that the Covered Group contact the *specified large customer* specifically to ask for information on the place of use of the service. Furthermore, it does not require seeking to amend an existing contract to add a new reporting obligation, nor to insert such a requirement in a future contract with the *specified large customer*. While a Covered Group is not precluded from taking measures beyond the reasonable steps described in this section, should it wish to do so, there can be no negative inference in respect of a Covered Group that met the reasonable steps requirement and then proceeded to use the *allocation key* in respect of any remaining Adjusted Revenues.

Box 67. Examples – Reasonable steps in the context of other services

The following examples illustrate the meaning of “reasonable steps” in the context of other services.

Example 1

The Covered Group provides cloud computing services to a *specified large customer*. The *specified large customer* does not have many fixed offices, and its employees are mainly teleworking, all in different Jurisdictions. For privacy and commercial reasons, the *specified large customer* cannot provide the personal employee information to the Covered Group. The Covered Group reviews the contract, but it does not contain any information on the place of use of the services. The Covered Group does not have any reliable information on the place of use of the services in its possession. The Covered Group has taken reasonable steps, and can use the *aggregate headcount allocation key*.

Example 2

The Covered Group provides cloud computing services to a *specified large customer*. It has a large number of *specified large customers*. It undertakes a sample review of 10 per cent of its contracts, and those contracts do not have any information on the place of use of the services. The Covered Group asserts that the sample is representative and that there is unlikely to be any information on the place of use of the services. The Covered Group has not satisfied the reasonable steps requirement as the sample size was too small.

2396. In order to be a *reliable method*, the *aggregate headcount allocation key* must be used in conjunction with the knock-out rule. The knock-out rule applies where the Covered Group knows of a legal, regulatory or documented structural commercial impediment such that sales were should not be made in certain Jurisdictions, even though it does not know positively in which Jurisdictions and in what proportions sales were actually made.

2397. The knock-out rule is mandatory. This means that the Covered Group must consider whether it has information that the services should not be used in a certain Jurisdiction because of legal or regulatory impediments or other documented structural commercial impediments, and if so, must remove all such Jurisdictions from the allocation.

2398. However, it is recognised that in cases where the Covered Group is already in the position where it has to use the *allocation key*, it may be that it does not have detailed additional information to apply the knock-out rule, and that a requirement to consider every sale or every contract would be unduly burdensome. As such, the knock-out rule is not required to be done on transactional level, but looking at the business more systemically at a category level, in discussion with the relevant operational and management team responsible for the relevant part of the business whether any such structural legal, regulatory or documented structural commercial impediments exist. See the discussion under Article 6(3) above on the meaning of legal, regulatory, or other documented structural commercial impediments.

2399. The Covered Group must apply the same approach to the knock-out rule for all Jurisdictions. The approach taken and the results of the knock-out rule will be reported separately in the Convention documentation, and the application the knock-out rule by the Covered Group must be reviewed each Period.

Box 68. Examples – Knock-out rule for other services

The following examples illustrate the application of the knock-out rule in the context of other services.

Example 1

The Covered Group provides legal and management consulting services to regulated businesses in the financial services sector. The nature of the services provided is such that an understanding of the regulatory environment within which their clients operate is necessary to provide the legal and management consulting services. The services provided by the Covered Group are organised into specific teams covering the regions in which it has clients. It does not have any staff that have expertise about the domestic legal system and regulatory regimes in Jurisdictions D, E and F and there are no teams that have been designated to cover these Jurisdictions. These Jurisdictions are knocked-out of the allocation.

Example 2

The Covered Group provides cloud computing and software packages. The *intangible property* underpinning these services is highly specialised and valuable. It is commercial practice, documented as a senior management policy, that it will not provide its cloud computing and software packages in Jurisdictions where its IP is not legally protected and where it cannot enforce its IP protection. The

Covered Group does not have IP protection in Jurisdictions G, H, I, J and K. These Jurisdictions are knocked-out of the allocation.

Example 3

The Covered Group provides services. It is headquartered in a Jurisdiction which has imposed trade sanctions against Jurisdictions L and M. This means that the Covered Group is legally prohibited, or will be subject to strong financial disincentives (such as denial of certain tax reliefs) if it provides services to those Jurisdictions. Jurisdictions L and M are knocked-out of the allocation.

Example 4

The Covered Group is providing cloud computing services to a customer. The customer is one of the Covered Group's *specified large customers*. No information is provided to the Covered Group on the place of use of the cloud computing service by the *specified large customer*. However, the Covered Group is aware that their *specified large customer's* operations are limited to a region comprising Jurisdictions I, J, K, L, M, N and O. The Covered Group proposes to allocate the Adjusted Revenues are to each of Jurisdictions I, J, K, L, M, N and O using the *aggregate headcount allocation key*. All other Jurisdictions are knocked-out of the allocation using the knock-out rule. Although the knock-out rule is intended to be applied at a category level, a Covered Group may opt to apply it at a more granular level (i.e., a contract level) where it has the information to do so.

2400. The *aggregate headcount allocation key* collates the headcount information reported by MNEs in their country-by-country report (as required by domestic legislation implementing BEPS Action 13), aggregated according to the Jurisdiction of the UPE. This, in turn, provides a percentage allocation of headcount located in each Jurisdiction. This information will be provided by the OECD. In this context, the term "resident" is interpreted as a resident specifically for country-by-country reporting purposes while the term has the meaning of a resident for tax purposes generally for other purposes of the MLC.

2401. This key must be used in respect of all *specified large customers*. The Covered Group is not required to determine whether the *specified large customer* did in fact file a country-by-country report, nor is the Covered Group required to determine the actual jurisdictional breakdown of the *specified large customer's* employees.

2402. In order to apply the *aggregate headcount allocation key*, the Covered Group will be required to use the key based on the *specified large customer's* UPE's residence for tax purposes. It presupposes knowing who the UPE is, in order to find their residence. In some cases, this will be straightforward, for example, where the information is public or otherwise known because of the importance of the customer relationship to the Covered Group or because the *specified large customer* is a household name. In other cases, it may not be possible to find out, recognising that it may not be obvious to the Covered Group that the customer is party of a larger international group and group structures can be hard to discern from public information.

2403. As such, the Covered Group is required to take a reasonable efforts approach to determine whether the *specified large customer* is part of a wider group and if so, where the UPE of the *specified large customer* is resident for tax purposes. This means checking the information that it has in its possession, for instance, in the client file. Where such information is not already in the possession of the Covered Group but is available from sources accessible to the Covered Group (e.g. a corporate registry system, public information from annual reports, stock exchange information, public country-by-country

filings, the customer's website, or a commercial database to which the Covered Group already has access) the Covered Group would be expected to extend their efforts to consult at least two such sources. The Covered Group should document its research process so that it can demonstrate that it made reasonable efforts to determine whether the *specified large customer* is part of a wider group and if so, where the UPE is resident for tax purposes. The Covered Group is not required to ask the *specified large customer*, nor is the Covered Group expected to undertake involved research of public sources to understand whether the *specified large customer* is a member of a wider group.

2404. If the Covered Group is able to identify the UPE, then it should identify the place where the UPE is resident for tax purposes. To do so, it may use information on the UPE's headquarters, principal place of business, or place of incorporation. If after the application of reasonable efforts, no information is available, the Covered Group may assume the UPE is resident in the same Jurisdiction as the *specified large customer*.

2405. The *aggregate headcount allocation key* provides that the Adjusted Revenues should be allocated in proportion to the aggregated employee headcount available for each Jurisdiction (see paragraph (a) of the definition of the *aggregate headcount allocation key*). Where the employee headcount is reported for each Jurisdiction, then this will be a straightforward multiplication of the Adjusted Revenues from that *specified large customer* by the percentage of headcount.

2406. In some cases, employee headcount is reported for some individual Jurisdictions but reported in aggregate for other groups of Jurisdictions; or it may be reported in the aggregate by groups of Jurisdictions (for example, by continent). In those cases, paragraph (b) of the definition of the *aggregate headcount allocation key* requires that Adjusted Revenues are allocated using the precise percentage that is applicable to any individually reported Jurisdictions (if any); and then to each group of Jurisdictions in proportion to the aggregated employee headcount available for each group. As a next step, the portion of Adjusted Revenues allocated to each Jurisdiction within that group is allocated in proportion to their percentage share of GDP (which reflects the relevant default *allocation key* for other services).

2407. In certain cases, aggregate headcount information will not be available for a Jurisdiction. This would be the case, for example, where the customer is part of an MNE whose UPE is located in a small Jurisdiction in which there is fewer than a de minimis number of enterprises filing country-by-country reports. In such cases, it would risk a breach of conveying confidential information to provide the aggregate headcount data for that Jurisdiction. A replacement key is provided in such cases, based on 50 per cent allocation to the Jurisdiction of the customer's UPE; and the other 50 per cent allocated using the *service allocation key* (which is an allocation based on GDP, which is the relevant default *allocation key* for other services) not including the Jurisdiction of the customer's UPE.

Box 69. Examples – Aggregate headcount allocation key

The following examples illustrates the application of the *aggregate headcount allocation key*.

Example 1

The Covered Group provides services to its customer, Happy Co, which it has determined is a *specified large customer* for the Period. The Adjusted Revenues from Happy Co are EUR 200m for the Period.

The UPE of the customer is Happy HQ. It is resident in Jurisdiction N for tax purposes.

The Covered Group applies the *aggregate headcount allocation key*, which provides the percentage breakdown of employees of all MNEs with their UPE resident in Jurisdiction N as reported in the headcount in country-by-country reports.

The respective shares of headcount are:

- Jurisdiction X: 65 per cent
- Jurisdiction Y: 10 per cent
- Jurisdiction Z: 7 per cent
- [etc. for remaining Jurisdictions]

Adjusted Revenues are sourced as follows:

- Jurisdiction X: 65 per cent x 200m = 130m
- Jurisdiction Y: 10 per cent x 200m = 20m
- Jurisdiction Z: 7 per cent x 200 = 14m
- [etc. for remaining Jurisdictions]

Example 2

The Covered Group provides services to its customer, Super Co, which it has determined is a *specified large customer* for the Period. The Adjusted Revenues from Super Co are EUR 500m for the Period. The UPE of the *specified large customer* is resident in Jurisdiction O for tax purposes.

The Covered Group applies the *aggregate headcount allocation key*, which provides the percentage breakdown of employees of all MNEs with their UPE resident in Jurisdiction O as reported in the headcount in country-by-country reports. Jurisdiction O aggregates employee headcount across Jurisdictions on a regional basis in its jurisdictional statistics, save for the employee headcount in Jurisdiction O which is separately reported.

The respective shares of headcount are:

- Jurisdiction O: 55 per cent
- Region A (comprising Jurisdictions P, Q, R and S): 23 per cent
- Region B (comprising Jurisdictions T, U, and V): 12 per cent
- [etc. for remaining regions and Jurisdictions]

Adjusted Revenues are sourced as follows:

- Jurisdiction O: 55 per cent x 500m = 275m
- Region A: 23 per cent x 500m = 115m

Respective share GDP	Allocation
Jurisdiction P: 20 per cent	$(20 / 50) \times 115 = 46\text{m}$
Jurisdiction Q: 10 per cent	$(10 / 50) \times 115 = 23\text{m}$
Jurisdiction R: 5 per cent	$(5 / 50) \times 115 = 11.5\text{m}$
Jurisdiction S: 15 per cent	$(15 / 50) \times 115 = 34.5\text{m}$

o Region B: 12 per cent x 500m = 60m

Respective share GDP	Allocation
Jurisdiction T: 2 per cent	$(2 / 6) \times 60 = 20\text{m}$
Jurisdiction U: 3 per cent	$(3 / 6) \times 60 = 30\text{m}$
Jurisdiction V: 1 per cent	$(1 / 6) \times 60 = 10\text{m}$

Indicators – Other services sold through resellers

2408. Annex D Section 3(F)(3)(a) sets a different set of indicators and *allocation key* in respect of certain sales of other services or digital content. These may be referred to commercially as resellers or independent distributors, and for convenience are referred to herein as resellers, as discussed above in paragraph 2361.

2409. This rule is mutually exclusive with the rule above in paragraph 2, meaning that even if the size of a contract would meet the same threshold as that which applies to a *specified large customer*, if the substance of the arrangement meets the following, then this rule in paragraph 3 applies. Those arrangements are referred to in paragraph 3 and are:

- The services or digital content are provided to a business customer;
- That business customer acquires the service or digital content subject to the condition that the service or digital content is solely for onward distribution or resale to third parties; and
- The service or digital content is not an input to facilitate the provision of a different service to a third party).

2410. To apply this rule, the Covered Group must identify the *transactions* with resellers. Generally, this would be evident from the contractual arrangements, and may also be managed as it is a separate business model with different marketing, customer management, legal and strategic issues than direct provision of services.

2411. The enumerated indicator included in paragraph 3(a)(i) is direct reporting on the place of use of the service by the final customer, from the final customer itself. This may occur, for example, in the case of resale of software, where the final customer registers the product directly with the Covered Group and includes information on its location such as its address. However, this would not be a *reliable indicator* if the Covered Group had actual knowledge that this was not the place of use of the service, for example, where the final customer is itself a *specified large customer* that acquires the service for use in multiple Jurisdictions.

2412. The enumerated indicator in paragraph 3(a)(ii) is information from reporting by the reseller on the place of use of the service. This may occur where the reseller provides performance reporting as to the sales it has made which include location information. The type of data points the reseller could use that are referenced in this paragraph 3(a)(ii) are any of those that appear in paragraph 2. In other words, the

reporting from the reseller may use any of those indicators without the Covered Group having to know whether the customer of the reseller was itself a *specified large customer* or smaller customer. However, this reporting from the reseller on the place of use by the final customer is expected to be rare in practice.

2413. The enumerated indicator in paragraph 3(a)(iii) is the location of the reseller. This paragraph mirrors that language of the rule for the sale of finished goods through independent distributors, as used in Annex D Section 1. This is subject to the condition that the reseller is contractually restricted to selling in that location or that it is otherwise reasonable to conclude that the reseller is located in the place of use of the services by the final customer.

2414. “Reasonable to conclude” does not require that the Covered Group has actual knowledge amounting to conclusive proof of the fact; but it means that based on the relevant facts and circumstances, it is more likely than not that the location of the reseller is the same as the place of use of the service by the final customers. It requires more than a mere assertion; it involves an objective analysis of the relevant facts and circumstances and weighing that evidence to determine whether it is reasonable to conclude that the location of the reseller is the same as the place of use of the service by the final customers.

2415. This could be the case, for example, where the reseller is a retailer (and therefore selling to final customers), and only sells in one Jurisdiction. It would also be the case where the Covered Group provides access to its services through access codes issued in physical form, which are sold by retailers. Given that the access to the service requires the customer to physically acquire the access code (as opposed to being provided directly online in which case the location of the final customer would not necessarily be tied to the location of the reseller), and that the nature of the product is such that it would be sold to an individual final customer, it would be reasonable to conclude that the location of the reseller is also the place of use by the final customer.

2416. However, unlike the case for independent distributors, the Covered Group is less likely to be able to reasonably conclude this is true. Services, unlike finished goods, are intangible and highly mobile. Covered Groups would need to have objective reasons supported by the facts and circumstances to be able to demonstrate that it was in fact reasonable to conclude that the reseller was co-located in the same Jurisdiction as the place that the final customer was using the services.

2417. As provided in Article 6(3)(b), another *reliable indicator* or an alternative *reliable indicator* could be used.

Box 70. Example – Alternative reliable indicator for other services sold through resellers

The following example illustrates the principles of an alternative *reliable indicator* in the context of other services sold through resellers.

The Covered Group sells cloud computing services through a reseller. As part of the service, the Covered Group assists some of the reseller’s customers with the installation and set-up of the service. As a result, the Covered Group has more information on some of these customers and knows that among them, there are 20 *specified large customers*. The Covered Group does not have reliable information on where these *specified large customers* use the service, but it has access to the *aggregate headcount allocation key* and would use the combination of the commercial information (i.e. the information obtained by providing the installation and set-up service) with an *allocation key* this as an alternative *reliable indicator* under Article 6(3)(b)(ii). In order to use the *aggregate headcount allocation key* for this purpose, the Covered Group would need to make a submission to the panel explaining the reasons for using this approach rather than using the indicators enumerated in Annex D

as required by Article 6(3)(b)(ii)(A). The Covered Group would also need to demonstrate to the panel that the approach produced results that were consistent with the sourcing rule and was otherwise reliable. In this respect as the use of the *aggregate headcount allocation key* is a *reliable method* for other services, the approach would meet the otherwise reliable standard.

Allocation key – Other services through resellers

2418. Some Covered Groups may not have access to reliable information to source the Adjusted Revenues of other services through resellers. In many cases, it is expected that Covered Groups will not obtain information from final customers or from resellers, because they either do not need it for their own commercial purposes, or because of competitive factors that exist between the business of the Covered Group and the business of the reseller. The difficulty of obtaining *reliable indicators* may be further compounded where complex supply chains exist (e.g. where the services are sold through multiple resellers before reaching the final customer), and where some Covered Groups may have thousands, or even millions, of resellers (which in turn can have thousands or even millions of customers).

2419. As such, the rule in paragraph 3 provides for an *allocation key*. This is the *service allocation key*, which is defined and uses macroeconomic information based on GDP. The use of an *allocation key* that is different to that used for other services (discussed above) recognises that in the case of resellers of services, the *aggregate headcount allocation key* (which would allocate based on headcount of the reseller, rather than the final customer) would not reflect the sourcing principle which looks to the final customer and not the reseller itself.

2420. As the *service allocation key* is an *allocation key* within the meaning of Article 6(3)(c), the prerequisites for it to be a *reliable method* in accordance with Article 6(3)(a)(iii) are that the use of the *allocation key* is expressly permitted in the rule (which is the case for this rule); that the Covered Group demonstrates that it has taken reasonable steps to identify an enumerated indicator and concluded that no such *reliable indicator* is available; and that the knock-out rule is applied. The latter two are discussed in turn.

2421. Reasonable steps are included in the rule to ensure that, insofar as practical, reliable information is obtained. The Covered Group is expected to use information that is available to it and that can feasibly be used to identify the Jurisdiction of use of the service by the final customer. For example, if a Covered Group selling other services through a reseller did obtain some reliable information on the location of use of the service by the final customers, this should be used, even if it does not cover all sales. Likewise, if technological solutions enabling the tracing of the services resold to the market Jurisdiction become commercial practice, this could be used to accurately source Adjusted Revenues from resellers. In that sense, the reasonable steps requirement future-proofs the rules as technology evolves and prevents over-reliance on the *service allocation key* to the extent possible.

2422. However, it is expected to be challenging to accurately trace the place of use of other services resold to the final market, for the reasons noted above. Therefore, the expectation of reasonable steps must be proportionate and take account of the costs and likely benefits.

2423. As such, a Covered Group selling other services through resellers would fulfil the reasonable steps requirement by having an in-depth and not merely perfunctory discussion with the relevant operational and management team responsible for the reseller business whether any reliable information was available to the business that could feasibly be used to identify the place of use of the services by the final customers. Where the reseller business is spread across a number of different business lines, discussions would be required with the responsible personnel across each relevant business line. . That discussion would not

require discussion of each individual reseller contract, and whether or not it was possible to track where the service was being used by the final customer but would be a broader discussion to understand whether any reliable information was available (and where reliable information is available for some or all of the sales, it should be used by the Covered Group). It would not include renegotiating a contract with a reseller, or include requiring reporting from the reseller in a future contract. The Covered Group is not expected to request any information that it does not ordinarily receive in the course of its business on the place of use of services sold by its resellers in order to source Adjusted Revenues. While a Covered Group is not precluded from taking measures beyond the reasonable steps described, should it wish to do so, there can be no negative inference in respect of a Covered Group that met the reasonable steps requirement and then proceeded to use the allocation key in respect of any remaining Adjusted Revenues. For examples on reasonable steps in this context, see the examples mentioned for Adjusted Revenues from finished goods sold through an independent distributor (under paragraph 2203) and the examples mentioned under Adjusted Revenues from other services (under paragraph 2395).

2424. The last pre-condition for using the *service allocation key* is the application of the knock-out rule. This is the same concept as discussed above generally in connection with *allocation keys* (see discussion under Article 6), and as further discussed as it applies to tail-end revenues from the sale of finished goods through an independent distributor and for components. It means that where the Covered Group knows of legal, regulatory or documented structural commercial impediments that mean its services that are sold through resellers should not be used by final customers in certain Jurisdictions, these are removed from the allocation, and no Adjusted Revenues are sourced to those Jurisdictions. It also means that where the Covered Group knows that its services that are sold through resellers are only used by final customers in a sub-set of Jurisdictions but does not know the proportions of use in each market, it can knock-out all other Jurisdictions.

2425. The knock-out rule would apply in cases where there is an objective, structural reason based on law or regulation, or other documented structural commercial impediment, that the services sold through resellers could not be used by final customers in a Jurisdiction.

Box 71. Example – knock-out rule for other services sold through resellers

The following example illustrates the application of the knock-out rule in the context of other services sold through resellers.

The Covered Group sells gaming software through resellers. The Covered Group does not have any information on the location of the resellers' final customers. However, all of the games are designed to be played by groups who communicate with one another through an online chat function which the software provides access to. The online chat function is subject to encryption technology that is banned in four Jurisdictions. The Covered Group can therefore apply the knock-out rule so that no Adjusted Revenues from the sales of that game through resellers are allocated to those four Jurisdictions.

2426. However, because the Covered Group selling through a reseller is further removed from the sale to the final customer, it may still be challenging to apply the knock-out rule. This may mean that the *service allocation key* applies to more than 100 Jurisdictions. In other words, the demands of the reasonable steps requirement for other services sold through resellers are in line with the expectations of the knock-out rule, given that in this context no further information may come to light. Following the fulfilment of the requirements of the reasonable steps requirement, the Covered Group could also consider the application

of the knock-out rule in that same discussion with the relevant operational and management team. See also the discussion of the *component allocation key* in the context of components for an example of the mechanical application of the *allocation key* and the knock-out rule.

Section 4 – Intangible property

Paragraph 1

Overview

2427. Article 7(1)(e) and Annex D Section 4 provide revenue sourcing rules for *intangible property*. The rules refer to the Adjusted Revenues from the licensing, sale or other alienation of *intangible property*. This is intended to ensure that the Adjusted Revenues from this category are captured irrespective of the legal form of the arrangement through which the Covered Group derives its Adjusted Revenues, and to therefore avoid characterisation disputes based on any such differences. However, this phrase is subject to the term Adjusted Revenues. That means that any gains that are derived from the alienation of *intangible property* that do not qualify as Adjusted Revenues are not within this category.

2428. The term *intangible property* is widely defined in Annex D and covers all types of property not in tangible form, including copyrights, trademarks, trade names, logos, designs, patents, know-how, and trade secrets, that is capable of being owned or controlled for use in commercial activities. The requirement that it be capable of being owned or controlled for use in commercial activities means that in order to be *intangible property*, there should be a right to make copies for commercial distribution, a right to use or modify the property to create derivative works, a right to make a public performance for commercial purposes, or the right to public display for commercial purposes. This means, for example, where a customer acquired software with the right to make some modifications, but those rights only extended to the ability to integrate the software into their systems (as opposed to rights to make modifications for the purpose of commercialising the resulting product), the *transaction* would not be with respect to *intangible property* (but would be digital content).

2429. However, the definition in Annex D provides that *intangible property* does not include:

- *Immovable property* (sourced using the rules in Article 7(1)(g));
- User data (sourced using the rules in Article 7(1)(f));
- Financial assets (typically treated as non-customer Revenues, see Article 7(2));
- Digital Content (sourced using the rules in Article 7(1)(b)); and
- Rights to use computer programs, which are digital content (see Article 7(1)(b), sourced in the same way as services) or which are, in some cases, components (see discussion above at paragraph 2364).

2430. The rules for sourcing income from *intangible property* have been designed to ensure coherent outcomes with the other rules so that the same sourcing result should apply whether a good or service is provided directly by a Covered Group or whether the Covered Group licenses *intangible property* to facilitate the provision of that good or service. This means that the rules for *intangible property* generally apply the same types of indicators as would be the case for the good or service ultimately delivered.

Sourcing rule – intangible property

2431. Article 7(1)(e) states the revenue sourcing principles for how Adjusted Revenues from *intangible property* are sourced. The treatment depends on what the *intangible property* is used for by the licensee or transferee, and there are three rules.

2432. Article 7(1)(e)(i) applies to *intangible property* that relates to finished goods or components. *Intangible property* relates to finished goods or components when it is used by the licensee, purchaser or other transferee in the production of the finished goods or components or when it is *intangible property* that exists because of the finished goods or components. The sourcing rule provides that the Adjusted Revenues are sourced to the Jurisdiction of delivery to the final customer of the finished goods (including the finished goods incorporating the component). The meaning of final customer is set out in paragraph 2184.

2433. The Jurisdiction of delivery to the final customer will be where the finished good that incorporates the *intangible property* or the finished goods that is otherwise related to the *intangible property* is delivered. For example, where the *intangible property* is a logo attached to clothing, the place of delivery is where the clothing was delivered to the final customer. If the *intangible property* related to a semi-conductor that was incorporated into a laptop for sale, the Jurisdiction of delivery will be the Jurisdiction of delivery of the laptop to the final customer. If the *intangible property* is an exclusive right to market finished goods in a Jurisdiction, the Jurisdiction of delivery of the finished goods will be that Jurisdiction. The indicators that would be used to source Adjusted Revenues are in line with those used for sourcing finished goods.

2434. Article 7(1)(e)(ii) applies if the *intangible property* is used to support the provision of a service or digital content. This would include music licensed to a streaming provider for use on their platform and films licensed to a cinema chain. In those cases, the Adjusted Revenues are sourced to the Jurisdiction of use of that service or digital content. The Jurisdiction of use of a service or digital content that is supported by the *intangible property* is determined in the same manner as the underlying service or digital content. As such, the indicators that would be used to source Adjusted Revenues from that service or digital content in Annex D Section 3 above are also used to source Adjusted Revenues from the *intangible property*.

2435. For example, in the case of music licensed to a streaming service, the Jurisdiction of use of the streaming service is determined using the customer's billing address (using the rules for other services) or in the case of a film shown in a cinema, it is the location of the cinema (as the cinema service is a *location-specific service*).

2436. Article 7(1)(e)(iii) applies if the *intangible property* is not otherwise related to a finished good or component and does not support the provision of a service or digital content. Adjusted Revenues from such *intangible property* are sourced to the Jurisdiction of use of the *intangible property*. This would include cases where the *intangible property* that is licensed has not yet been developed to a degree to enable it to be incorporated into a finished goods or to support a service. Such arrangements are common in the pharmaceutical industry, for example, where *intangible property* is often licensed to a third party that works to incorporate it into a new drug which may not materialise (referred to in some cases as "uncommercialised intangible property"). Different indicators apply depending on whether the contract is one of the Covered Group's larger *intangible property* contracts, as discussed below.

2437. Annex D Section 4(1) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from *intangible property*.

Paragraph 2

Indicators – intangible property related to finished goods or components or that supports a service or digital content

2438. Annex D Section 4(2) provides detailed rules on the indicators that should be used for *intangible property* related to finished goods and components and *intangible property* that support a service or digital content.

Intangible property related to finished goods or components

2439. Paragraph 2(a)(i) outlines the indicators that can be used where *intangible property* relates to a finished good or a component. *Intangible property* falls within this sub-category when it is used by the licensee in the production of a finished good or in the production of a component. *Intangible property* also falls within this category when it exists because of the finished goods or components. This does not mean that all *intangible property* that is tangentially or indirectly supporting the production of finished goods is sourced under this rule, such as the Covered Group's *intangible property* that is contained in the Covered Group's own finished good, as that would not be the predominant nature of the Adjusted Revenues. Rather, it means that the Covered Group is earning a specific stream of Adjusted Revenues from providing the rights to the *intangible property*, and this *intangible property* is provided to facilitate the licensee's own provision of its finished goods or components.

Box 72. Examples – Intangible property related to finished goods or components

Typical examples of *intangible property* that relates to finished goods or components include the following.

Example 1

A Covered Group owns a luxury brand. It licences its brand to a perfume manufacturer to use the brand on the perfume it sells. The brand licence will be *intangible property* related to a finished good.

Example 2

A Covered Group licences the patented formula to make the active pharmaceutical ingredient for a drug to MNE 1. MNE 1 makes the active pharmaceutical ingredient and sells that as a component to MNE 2 that produces the final drug. The *intangible property* is *intangible property* related to a component and the Adjusted Revenues should be sourced to the Jurisdiction of delivery to the final customer of the drug produced by MNE 2.

Example 3

A Covered Group licenses a patented manufacturing process that reduces the time it takes to cut and shape steel to an automotive business. The licence of the manufacturing process will be *intangible property* that is related to the vehicle (the finished Good) produced by the automotive business.

Example 4

A Covered Group makes cell phones. In return for granting an exclusive licence to Distributor A to distribute the mobile phones in Jurisdiction A, it receives an annual payment (separate to the cost of the mobile phones). The exclusive right to distribute the cell phones in Jurisdiction A is *intangible property* related to finished goods.

2440. As discussed at paragraph 2430, the indicators identified in paragraph 2(a)(i) reflect those used for sourcing Adjusted Revenues from finished goods and look to the Jurisdiction of delivery of the finished good to the final customer. They also align with the indicators used for sourcing Adjusted Revenues from components.

2441. The indicators are the Jurisdiction(s) of delivery of the finished goods to the final customer reported to the Covered Group by the licensee, purchaser or other transferee (as applicable); or the place of the retail store selling the finished goods to the final customer.

2442. As provided in Article 6(3)(b)(i), another *reliable indicator* may also be used.

Box 73. Example – Another reliable indicator for intangible property related to finished goods or components

The following example illustrates the principles of another *reliable indicator* in the context of *intangible property* related to finished goods or components:

A Covered Group licenses a patented formula and the associated brand name for a pharmaceutical drug to a manufacturer for global distribution. The pharmaceutical drug has been authorised for sale in 50 Jurisdictions. The Covered Group subscribes to a database maintained by a third party that reports international sales of a range of pharmaceutical drugs, including the drug manufactured using the licensed formula. The database includes complete details of the authorised sales information for each of the 50 Jurisdictions where the drug is authorised for sale. The third party that collates the database is in the business of collating distribution information relating to pharmaceutical drugs and charges subscribers for access to the data. As such, the third party uses the data for commercial reasons. Accordingly, the information meets the conditions of Article 6(3)(b)(i) and is another *reliable indicator*.

2443. As provided in Article 6(3)(b)(ii), an alternative *reliable indicator* may also be used.

Box 74. Example – Alternative reliable indicator for intangible property related to finished goods or components

The following example illustrates the principles of an alternative *reliable indicator* in the context of *intangible property* related to a finished good or component:

A Covered Group licences *intangible property* in the form of the trademarks, brand name, and copyright related to a cartoon character to a global toy manufacturer to manufacture and distribute toys using that *intangible property*. The Covered Group operates a fan club for the cartoon character but membership is only available using the serial code on merchandise sold by the toy manufacturer. As the fan club gives members access to additional content related to the cartoon character a high proportion of those who purchase the products join the fan club and provide their address as part of the subscription process. The Covered Group knows that there is a high proportion of enrolment in the fan club based on the numbers of serial numbers of products sold that are reported. The Covered Group uses the

information provided by the final customers to target those individuals with advertising and other marketing related to the cartoon character and other similar brands. The Covered Group applies for *advance certainty* to use this as an alternative *reliable indicator* under Article 6(3)(b)(ii). As such, the Covered Group would be required to demonstrate that the proposed approach produces results that are consistent with the sourcing rule (in that it identifies the Jurisdiction of delivery of the toys to the final customers) as required by Article 6(3)(b) and to explain to the *review panel* (or the *determination panel*) in the *advance certainty review* the reasons for using the proposed approach rather than the indicators enumerated in Annex D, as required by Article 6(3)(b)(ii)(A), and that the information provided by the final customer on joining the fan club was otherwise reliable, as required by Article 6(3)(b)(ii)(A). In this respect, the high level of take-up for the fan club by final customers and the fact that the information was used for targeted marketing purposes would be persuasive.

Intangible property that supports a service or digital content

2444. The meaning of *intangible property* that “supports” a service or digital content does not mean that all *intangible property* that is tangentially or indirectly supporting another service or digital content is sourced under this rule (such as the Covered Group’s know-how that is provided in the course of that Covered Group providing a consultancy service), as that would not be the predominant nature of the Adjusted Revenues. Rather, it means that the Covered Group is earning a specific stream of Adjusted Revenues from providing the rights to the *intangible property*, and this *intangible property* is provided to facilitate the licensee’s own provision of its services or digital content.

2445. Article 7(1)(e)(ii) provides that the Adjusted Revenues from *intangible property* that supports a service are sourced to the Jurisdiction of use of that underlying service. In this context the Jurisdiction of use of the underlying service means the Jurisdiction where Adjusted Revenues in respect of that underlying service would be treated as arising. For example, the Jurisdiction of use of an advertising service that was supported by *intangible property* would be the location of the viewers of the ads. As such, the Jurisdiction of use of the service is identified using the same approach and the same indicators (including another *reliable indicator* and an alternative *reliable indicator*) as applies for the relevant type of underlying service, as set out in the rules for sourcing services in Annex D Section 3. It also applies to *intangible property* that supports digital content; in which case it is also sourced as per the rules in Annex D Section 3(F).

2446. If the *intangible property* supports another service the rules would require the Covered Group to determine whether those services were provided to a *specified large customer* or a smaller customer. As the Covered Group would not be able to make that determination (given it is quite removed from the final customer), the Covered Group may use any of the indicators included in Annex D Section 3(F)(2) to identify the Jurisdiction of use of the other service supported by the *intangible property*. In other words, the Covered Group may use any of those indicators without having to know whether the final customer was itself a *specified large customer* or smaller customer. However, access to indicators on the Jurisdiction of use by the final customer is expected to be rare in practice.

Box 75. Examples – Intangible property that supports a service or digital content

Typical examples of *intangible property* that supports a service or digital content include the following.

Example 1

The Covered Group is an entertainment group that produces cartoons. It licenses the trademarks and other *intangible property* of one of its cartoon characters to a theme park operator to develop a theme park based on that cartoon character. The Adjusted Revenues from the licence are Adjusted Revenues from *intangible property* used to support a service. That service (the theme park) would be characterised as a service performed at the location of the customer. As such, the Adjusted Revenues from the *intangible property* should be sourced using the indicators identified in Annex D Section 3(A) (in this case, the location of the theme park).

Example 2

The Covered Group is a franchisor, which grants the rights to operate a fast-food restaurant to a franchisee. As a restaurant service would be a service performed at the location of the customer and the *intangible property* supports that service, the indicators identified in Annex D Section 3(A) would be used and the Adjusted Revenues would be sourced to the Jurisdiction of the location of the restaurant.

Example 3

The Covered Group provides a licence of patented or copyrighted computer code to a business that in turn intends to use and develop the code to improve its cloud service offering. In that case, the *intangible property* would be supporting the provision of another service and the Adjusted Revenues should be sourced using the indicators included in Annex D Section 3(F).

Example 4

A Covered Group owns the trademark and copyright to a fictional action hero. The Covered Group provides a license to a computer game creator, to use that action hero in its computer game. In that case, the *intangible property* would be supporting the provision of a digital content, and the Adjusted Revenues should be sourced using the indicators included in Annex D Section 3(F).

Example 5

A Covered Group licences films to a streaming service for distribution to customers of the streaming platform. In that case the *intangible property* would be supporting the provision of another service and the Adjusted Revenues should be sourced to the Jurisdiction of use of the streaming service using the indicators included in Annex D Section 3(F).

Example 6

A Covered Group licences a movie for distribution to a cinema chain. As a cinema service would be a service performed at the location of the customer, the indicators identified in Annex D Section 3(A) would be used and the Adjusted Revenues would be sourced to the Jurisdiction of the location of the cinema.

Example 7

A Covered Group with a music production business authorises the use of its music as part of the soundtrack in an advertisement. In that case the *intangible property* would be supporting the provision of an advertising service and the Adjusted Revenues should be sourced using the indicators included in Annex D Section 3(B)(2) or (3). However, it should be noted that given the Covered Group is not directly involved in the provision of the advertising, it will be unlikely to be in a position to use *reliable indicators*.

2447. Under Article 6(3)(b)(i) another *reliable indicator* may also be used to source Adjusted Revenues.

Box 76. Example – Another reliable indicator for intangible property that supports a service or digital content

The following example illustrates the application of another *reliable indicator* in this context.

A Covered Group licenses a range of television programs and movies to a streaming service over a three-year period. The streaming provider is permitted to distribute the content globally. The streaming provider does not report the location of the final customers. However, for accounting purposes the Covered Group is required to determine when and how the Adjusted Revenues from the three-year contract should be recognised. To satisfy this obligation the Covered Group tracks launch dates and other data related to the consumption of the content globally and determines how the payments received should be recognised over the three years and in what regions. The Covered Group's external auditors confirm this analysis. The analysis prepared and reviewed by the auditors would be considered another *reliable indicator* under Article 6(3)(b)(i) as it is consistent with the source rule and is prepared to satisfy other legal obligations, and it also has the benefit of being subject to an external third party review.

2448. As provided in Article 6(3)(b)(ii), an alternative *reliable indicator* may be used to source Adjusted Revenues from *intangible property* that supports a service or digital content.

Allocation keys – intangible property related to finished goods or components or that supports a service or digital content

2449. Annex D Section 4(2)(b) provides *allocation keys* for any remaining Adjusted Revenues after the application of Annex D Section 4(2)(a). There are two *allocation keys* provided in the rule: the *regional allocation key*; and the *global allocation key*.

2450. As these are both *allocation keys* within the meaning of Article 6(3)(c), the prerequisites for it to be a *reliable method* in accordance with Article 6(3)(a)(iii) are that the use of the *allocation key* is expressly permitted in the rule (which is the case for this rule); that the Covered Group demonstrates that it has taken reasonable steps to identify an enumerated indicator and concluded that no such *reliable indicator* is available; and that the knock-out rule is applied. The reasonable steps requirement is discussed first, with respect to *intangible property* relate to finished goods or components, and again with respect to *intangible property* that supports a service or digital content. The application of the knock-out rule and the *allocation keys* is then discussed.

Reasonable steps for intangible property related to finished goods or components

2451. In the case of *intangible property*, the Covered Group does not transact directly with the final customer. As such, in some cases the Covered Group may not have *reliable indicators* on the Jurisdiction of delivery of the finished good to the final customer. Further, the immediate business to which the *intangible property* is licensed or transferred also may not know the Jurisdiction of delivery (for example, if it in turn uses an independent distributor, or it is using the *intangible property* in the production of a component which is in turn incorporated into a finished good by a separate MNE). The licensee or transferee may also be unwilling to divulge information on the locations of the final customers, even if it

was available. It is for this reason that the rule provides *allocation keys*, thus ensuring that all Adjusted Revenues from *intangible property* can be sourced. At the same, there will be cases where the Covered Group does have access to information (typically from the licensee) on the Jurisdiction of delivery of the finished goods to the final customer. This is usually because the licensor of the *intangible property* can limit where and how the licensee may use the *intangible property* under the terms of the *intangible property* contract and may require periodic reporting on where finished goods are delivered to final customers. This information must be used when it is available as outlined in the discussion below.

2452. In order for the *allocation keys* to be a *reliable method*, the Covered Group must take “reasonable steps” to identify enumerated indicators. While a Covered Group is not precluded from taking measures beyond the reasonable steps described below, should it wish to do so, there can be no negative inference in respect of a Covered Group that met the reasonable steps requirement and then proceeded to use the *allocation key* in respect of any remaining Adjusted Revenues.

2453. Given the sensitivity of *intangible property* to a business and the need to ensure such property is protected, and the breadth of business models involved in earning Adjusted Revenues from *intangible property*, there are circumstances in which a Covered Group would be more likely to have *reliable indicators*, and as such, those circumstances need to be taken into account in ensuring the reasonable steps are proportionate. There are two factors that influence the extent of the reasonable steps that should be taken: (i) if the consideration payable under the arrangement depends on the Adjusted Revenues earned by the licensee; and (ii) if the Covered Group has significant authority over the licensee’s or transferee’s exploitation of the *intangible property*. Where the Covered Group manages its *intangible property* business by having either of these features in its contractual arrangements, it is likely to have, or be entitled to receive, data on the Jurisdiction where the related finished goods are delivered to the final customer.

2454. Confirming whether or not that is the case will typically involve a review of the Covered Group’s *intangible property* contracts. Given that the approach above necessarily requires a manual process to review the relevant contracts, in cases where the result will sometimes be that the Covered Group has no visibility on the final Jurisdiction of delivery of the finished goods, compliance burdens are taken into account in defining the extent of the reasonable steps requirement.

2455. As such, a risk-based approach is adopted and the reasonable steps requirement for *intangible property* related to finished goods or components requires that the Covered Group is expected to review:

- a) the *intangible property* contracts with the 200 customers from which it generates the most Adjusted Revenues from the licensing, sale or other alienation of *intangible property* in a Period, provided that the contracts with each customer generate in aggregate in excess of EUR 20 million in Adjusted Revenues per customer for the Period; and
- b) all *intangible property* contracts with customers from which it generates in aggregate more than EUR 100 million of Adjusted Revenues from the licensing, sale or other alienation of *intangible property*,

2456. to determine whether the two features identified in paragraph 2453 are present. If either of those features are present, it must confirm whether it has access to enumerated indicators to determine the Jurisdiction of delivery of the finished good to the final customer. In respect of the remaining contracts, the Covered Group would be permitted to use the *global allocation key* provided in paragraph 2(b)(ii).

2457. Accordingly, a Covered Group licensing or selling *intangible property* related to a finished good or component would fulfil the reasonable steps requirement if it took the following steps:

- a) Identify the top 200 *intangible property* customers from which it generates the most Adjusted Revenues from the licensing, sale or other alienation of *intangible property* for the Period (other than those that generate in aggregate EUR 20 million or less in Adjusted Revenues from the licensing, sale or other alienation of *intangible property* for the Period);
- b) Identify any customer from which it generates more than EUR 100 million of Adjusted Revenues from the licensing, sale or other alienation of *intangible property* in a Period;
- c) In respect of the *intangible property* contracts with the customers selected under step (a) and step (b), identify those contracts in respect of which the licence fee / royalty / other consideration was tied to the returns earned by the licensee or transferee, and those *intangible property* contracts where the Covered Group had significant control rights.
- d) In respect of the *intangible property* contracts with customers selected under step (c), review the contracts and the data provided by the licensee or other transferee pursuant to the contractual requirements (and request the data which the Covered Group is contractually entitled to if it is not provided by the licensee or other transferee) to assess whether the Jurisdiction of delivery of the finished goods can be determined.

2458. Reasonable steps do not require the Covered Group to renegotiate the contract with a customer, or to include a reporting requirement in a future contract, or to request additional information that it is not entitled to receive under the terms of the contract.

2459. If no data on the source is available to the Covered Group under step (d), it may use the *allocation keys* to source the Adjusted Revenues, as discussed below and in conjunction with the knock-out rule. In respect of the other contracts the Covered Group is permitted to use the *global allocation key* in conjunction with the knock-out rule, without first undertaking a review of the contract or contractual information.

Box 77. Examples – Reasonable steps for intangible property related to finished goods or components

The following examples illustrate the application of the reasonable steps requirement in the context of *intangible property* related to a finished Good.

Example 1

A Covered Group licenses a number of trademarks to a clothing company, which manufactures and sells t-shirts with those trademarks attached. The trademarks are highly valuable, and are central to the Covered Group's brand and products, and it is commercial practice for the Covered Group to maintain a high degree of visibility over where its trademarks are commercialised. The clothing company is one of the top 200 *intangible property* customers by Adjusted Revenues of the Covered Group in a Period, and the *intangible property* contracts with the clothing company generate in excess of EUR 20 million for the Period. The Covered Group is therefore required to review the terms of the licences to understand whether the licence fees in any case are tied to the returns earned by the licensee or if the Covered Group had significant control rights under any of the licences. In each case the Covered Group is entitled to a royalty that fluctuates depending on the sales made by the licensee. The reasonable steps requirement therefore requires the Covered Group to understand whether it has access to information that would satisfy the enumerated indicators. The contracts in each case provide for the licensee to report the underlying sales information in relation to the licensee's sales of the t-shirts with

the trademarks, on a Jurisdiction-by-Jurisdiction basis. Given that the Covered Group has access to such information (whether on request or automatically) as part of the contractual arrangement, the reasonable steps requirement means that the Covered Group should obtain and use that information for the purpose of revenue sourcing.

Example 2

A Covered Group produces detergent. It licenses the brand name of its detergent to be affixed to household appliances that are manufactured and sold by a separate MNE. The Covered Group receives a fixed, one-off fee only of EUR 120 million. The Covered Group is therefore required to review the terms of the licence to understand whether the licence fee is tied to the returns earned by the licensee or if the Covered Group had significant control rights under the licence. Based on a review of the contract, it has no rights to information on where, or in what volume, the goods are sold that have the detergent brand name attached to them. It has no other control over the way the appliance manufacturer exploits the brand name. It therefore could be treated as having satisfied the requirement to take reasonable steps by reviewing the terms of the licensing arrangement to confirm that the Adjusted Revenues were not tied to the returns earned by the licensee and that that it did not have significant control rights and therefore it had no access to information regarding the Jurisdiction of delivery to the final customer.

Example 3

A Covered Group licenses the patented formula to make a pharmaceutical drug to another MNE. It also licenses the same MNE the brand name under which the Covered Group usually sells that pharmaceutical drug. The licensee is one of the top 200 *intangible property* customers by Adjusted Revenues of the Covered Group in a Period, and generates in excess of EUR 20 million for the Period. The Covered Group is therefore required by the reasonable steps requirement to examine the terms and conditions of the licence to understand whether the licence fee is tied to the returns earned by the licensee or if the Covered Group had significant control rights under the licence. Under the terms of the licence, the Covered Group restricts the other MNE's right to use the patented formula solely to make that pharmaceutical drug (i.e., the other MNE is not permitted use the formula to develop other, new drugs) and requires that the drug be sold under the licensed brand name. Further, the other MNE is restricted from using the brand name for any other purpose. The Covered Group has rights to inspect the premises where the drug is manufactured by the other MNE and rights to undertake regular quality control checks on the drugs manufactured. Given the terms of such an arrangement, the Covered Group has significant control rights. In those circumstances, the reasonable steps requirement means that the Covered Group would be required to further review the contract to understand whether the licensee was required to report information that the Covered Group could use as enumerated indicators (e.g., information about the Jurisdictions where the manufactured drugs were ultimately sold and in what quantities). If the Covered Group has the contractual right to receive such information (whether on request or automatically), the reasonable steps requirement means that the Covered Group should obtain and use that information for the purpose of revenue sourcing.

Example 4

A Covered Group in the entertainment industry licenses the rights to use certain copyrights related to cartoon characters (character, name, likeness, etc.) to a third-party merchandiser to produce and sell promotional products depicting those characters. The Covered Group receives fixed fees under the licences totalling of EUR 30 million in a Period. The licensee is one of the top 200 *intangible property* customers by Adjusted Revenues of the Covered Group in a Period, and generates in excess of EUR 20 million for the Period. The Covered Group is therefore required by the reasonable steps requirement to examine the terms and conditions of the licences to understand whether the licence fee in any case

is tied to the returns earned by the licensee or if the Covered Group had significant control rights under any of the licences. Although the Covered Group restricts permissions in the contracts such as not interfering in the design of the character, and restricts the general nature of products to which the character can be attached (e.g. to baby products, shampoo), it does not place detailed obligations on the quality standards the products must meet, nor does it in any case restrict where those goods may be sold. The Covered Group has no right to inspect the premises where the manufacturing takes place and no right to perform quality control checks on the manufactured products. In those circumstances, the Covered Group does not have significant control rights and does not earn its Adjusted Revenues in a way that is tied to the underlying performance of the licensee. It therefore could be treated as having satisfied the requirement to take reasonable steps by certifying that the Adjusted Revenues were not tied to the returns earned by the licensee and that it did not have significant control rights and therefore it had no access to information regarding the Jurisdiction of delivery to the final customer.

Example 5

A Covered Group licenses the patented formula of a successful drug to a third party that is entitled to exploit the patent globally. The Covered Group is entitled to a royalty that fluctuates depending on the sales made by the licensee. In addition, once the sales made by the licensee exceed EUR 500 million, the Covered Group becomes entitled to a bonus milestone payment of EUR 50 million. The customer is one of the top 200 *intangible property* customers by Adjusted Revenues of the Covered Group in a Period, and generates in excess of EUR 20 million for the Period. The Covered Group is therefore required by the reasonable steps requirement to examine the terms and conditions of the licence to understand whether the licence fee is tied to the returns earned by the licensee or if the Covered Group had significant control rights under the licence. Under the terms of the licence, the licensee is required to report the underlying sales information relating to the licensee's sales of the drug on a Jurisdiction-by-Jurisdiction basis. Given that the Covered Group has access to such information (whether on request or automatically) as part of the contractual arrangement, the reasonable steps requirement means that the Covered Group should obtain and use that information for the purpose of sourcing the on-going royalty payment. The Covered Group would also be expected to use the information it had to reliably source the bonus milestone payment. As the sales which gave rise to the bonus milestone payment accumulated over a number of years, this would require the Covered Group to review historic sales information provided to it, for the Periods to which the milestone payment relates. If that Period related to years prior to the application of the Convention, information that covers all Periods for which the Convention was in effect should be used, but the Covered Group is not required to collate the information for those prior years.

Reasonable steps for intangible property that supports a service or digital content

2460. As is the case for *intangible property* related to a finished good, the Covered Group licensing the *intangible property* will have no direct involvement in the provision of the service or the digital content. In many cases, the indicators applicable to the service supported by the *intangible property* will be beyond the limits of the Covered Group's commercial knowledge. This is particularly the case where the *intangible property* supports advertising, where the applicable indicators relate to the location of the viewer or where the advertising was targeted; online intermediation services, where the indicators relate to the location of users of that service; transport services, where the sourcing is by reference to the place of destination and place of origin of the transportation carried out by the transportation MNE; and customer reward programs where the indicators relate to the location of active members. At the same, there will be cases where the Covered Group does have access to information (typically from the licensee) on the Jurisdiction of use of the service supported by the *intangible property*. This is usually because the licensor of the *intangible*

property can limit where and how the licensee may use the *intangible property* under the terms of the *intangible property* contract and further can require periodic reporting on where the services supported by the licence were used. This information must be used when it is available as outlined in the discussion below. As such, the obligation is for the Covered Group to take “reasonable steps” to identify enumerated indicators, based on the nature of the contractual and commercial arrangement and the relevant costs and likely benefits. While a Covered Group is not precluded from taking measures beyond the reasonable steps described below, should it wish to do so, there can be no negative inference in respect of a Covered Group that met the reasonable steps requirement and then proceeded to use the *allocation key* in respect of any remaining Adjusted Revenues.

2461. In this regard, the analysis under *intangible property* related to finished goods also applies to *intangible property* that supports a service or digital content insofar as it explains the extent of the reasonable steps that should be taken with respect to different *intangible property* contracts (summarised below), with the exception of *intangible property* that supports a *location-specific service*.

2462. In respect of *intangible property* that supports a *location-specific service*, given the location is a fundamental term of the licensing arrangement, there is not the same potential for difficulty in ascertaining the place of final use, and therefore not the same need to reduce the burdens of a manual contract review. For example, given the nature of franchising, that would be a case where it would be expected that the Covered Group should have *reliable indicators* to determine the Jurisdiction of use of the service (which typically would be a *location-specific service*) regardless of the number of *intangible property* contracts of the Covered Group. As such, the reasonable steps requirement means that a Covered Group must review all of its contracts for *intangible property* that supports a *location-specific service*.

2463. For all other *intangible property* supporting services other than *location-specific services*, and for *intangible property* supporting digital content, a Covered Group will be treated as having taken reasonable steps if:

- a) it identifies the top 200 customers from which it generates the most Adjusted Revenues from the licensing, sale or other alienation of *intangible property* for the Period (other than those that generate EUR 20 million or less in such Adjusted Revenues for the Period);
- b) It identifies any customer from which it generates more than EUR 100 million in Adjusted Revenues from the licensing, sale or other alienation of *intangible property* in a Period;
- c) in respect of the customers selected under step (a) and (b), it identifies the *intangible property* contracts with those customers where the licence fee / royalty / other consideration was tied to the Adjusted Revenues earned by the licensee or transferee, and those *intangible property* contracts where the Covered Group had significant control rights;
- d) in respect of the contracts identified under step (c), it reviews the data provided by the licensee or other transferee pursuant to the contractual requirements (and requests the data which the Covered Group is contractually entitled to if it is not provided by the licensee or other transferee) to assess whether the source of the Adjusted Revenues can be determined.

2464. Reasonable steps do not require the Covered Group to renegotiate *intangible property* contracts with a customer, or to include a reporting requirement in any future contract, or to request additional information that it is not entitled to receive under the terms of the contract(s).

2465. If no data on the source is available to the Covered Group under step (d), it may use the *allocation keys* to source the Adjusted Revenues, as discussed below and in conjunction with the knock-out rule. In

respect of the other contracts the Covered Group is permitted to use the *global allocation key* in conjunction with the knock-out rule without first undertaking a review of the contract or contractual information.

Box 78. Examples – Reasonable steps for intangible property that supports a service or digital content

The following examples illustrate the application of the reasonable steps requirement in the context of *intangible property* used to support services or digital content.

Example 1

The Covered Group owns a cartoon character. The cartoon character is a highly valuable and globally recognised part of its brand. Theme parks based on the cartoon character have been developed. Given this is *intangible property* supporting a *location-specific service*, in order for the Covered Group to meet the reasonable steps obligation, it should review the contract and/or information reported pursuant to the contract to identify the location, and use this information to source the Adjusted Revenues from the licensing of the *intangible property*.

Example 2

The Covered Group is a franchisor of a restaurant and has appointed over 700 franchisees internationally. Under the terms of the franchise agreements franchisees use *intangible property* developed by the Covered Group (including its brand name, logo and know-how) in return for a franchise fee. As the *intangible property* supports the provision of a *location-specific service*, in order for the Covered Group to meet the reasonable steps obligation, it should review the contracts and/or information reported pursuant to the contracts to identify the location, and use this information to source the Adjusted Revenues from the licensing of the *intangible property*. Even though the Covered Group has in excess of 200 *intangible property* contracts, this is a case where it would be expected to review each contract to determine the Jurisdiction of use of the service individually because it is *intangible property* supporting a *location-specific service*.

Example 3

The Covered Group provides a licence of patented or copyrighted computer code to a business that uses it to further develop and improve its cloud service offering. The licensee pays a fixed upfront fee of EUR 15 million and the licence is the Covered Group's only *intangible property* contract with that customer. The Covered Group is permitted to use the *global allocation key* without undertaking a review of the contract.

Example 4

A Covered Group in the entertainment industry licensed its television series to another MNE that operates a streaming service for distribution globally across its platform over a twelve month period. The commercial nature of the business is such that it also imposes jurisdictional restrictions on where certain series can be shown. In return the streaming platform pays a royalty that is based on a revenue sharing arrangement (so that it increases with the number of subscribers to the streaming service). The reporting that the platform provides includes a breakdown of subscriptions by Jurisdiction, which also enables the Covered Group to verify the remuneration and that no breaches of the jurisdictional restrictions have occurred. If this was one of the top 200 *intangible property* customers for the Period or if the Covered Group derived Adjusted Revenues from the licensing, sale or other alienation of *intangible property* exceeding EUR 100 million from that customer in a Period, the Covered Group

would be obliged to review the terms of the contract. Given the contract includes a royalty that fluctuates depending on the number of subscribers to the service, and that the Covered Group has access to this information (whether on request or automatically) as part of the contractual arrangement, the reasonable steps requirement means that the Covered Group should obtain and use that information for the purpose of revenue sourcing.

Example 5

A Covered Group receives a one-off fixed payment for an international licence of music to a movie production company for incorporation into the soundtrack of a film. It is the only revenue that the Covered Group earns in respect of *intangible property* from that customer. The Covered Group receives no information about the movie, its proposed release date or intended Jurisdictions of release. It may even be the case that the soundtrack is never incorporated into a movie by the licensee. In those circumstances, the Covered Group has no control over when (and even if) the content is used in the film, and when or where that film might ultimately be distributed and viewed. If this was one of the top 200 *intangible property* customers for the Period or if the Covered Group derived Adjusted Revenues from the licensing, sale or other alienation of *intangible property* exceeding EUR 100 million from the customer in a Period, to fulfil the reasonable steps requirement, the Covered Group would certify as part of its documentation that the licence fee was a fixed fee and that it did not have significant control rights under the terms of the licence and would be permitted to use the *allocation keys*. If this was not one of the top 200 *intangible property* customers for the Period and the Adjusted Revenues did not exceed EUR 100 million, it would also be permitted to use the *allocation keys*.

Applying the allocation keys and the knock-out rule

2466. Annex D Section 4(2)(b) provides that if the Adjusted Revenues are derived from a *specified large intangible property customer* or from a contract under which the *intangible property* supports a *location-specific service*, the *allocation keys* must be applied in the following order: first, the *regional allocation key* and then the *global allocation key*.

2467. *Specified large intangible property customer* is a defined term and covers customers from which the Covered Group derives Adjusted Revenues from *intangible property* if:

- a) The Adjusted Revenues from the licensing, sale or other alienation of *intangible property* exceed EUR 20 million in a Period and the customer is one of the 200 customers from which the Covered Group derives the most *intangible property* Adjusted Revenues in the Period; or
- b) The Adjusted Revenues from the licensing, sale or other alienation of *intangible property* exceed EUR 100 million in a Period.

2468. The approach is designed to capture the *intangible property* contracts agreed with *specified large intangible property customers* (as discussed below in paragraph 2483), as well as those contracts for *intangible property* that support *location-specific services*. This approach aligns with the types of contracts for which the reasonable steps requirement involves a review of the contract by the Covered Group. For *intangible property* contracts with *specified large intangible property customers* and contracts where the *intangible property* supports *location-specific services*, the Adjusted Revenues that are not sourced using *reliable indicators* should be sourced using the *regional allocation key*.

2469. The *regional allocation key* applies where the *intangible property* can be exploited by the licensee, purchaser or other transferee with final customers in a particular *identified region* (which is defined as any group of Jurisdictions, irrespective of geographical proximity where the licensee, purchaser or other transferee is permitted to exploit *intangible property* licensed, sold, or otherwise alienated by the Covered Group), but the Covered Group does not know the proportions of such use in each Jurisdiction. The *regional allocation key* provides an approximation whereby Adjusted Revenues are treated as arising in the Jurisdictions in that *identified region*, in proportion to their percentage shares of *final consumption expenditure*. This is the same as the *regional allocation key* that can be used in the context of finished goods sold through an independent distributor.

2470. Using the *regional allocation key* requires the Covered Group to review the relevant contractual arrangement in each case to identify whether the rights to use the *intangible property* are restricted to a particular group of Jurisdictions. For *intangible property* that supports *location-specific services*, the region would be expected to comprise the Jurisdictions where the *location-specific services* are performed. For contracts with *specified large intangible property customers*, the analysis must be undertaken on a per contract basis and the *identified region* will comprise the Jurisdictions where the relevant contract permits the licensee, purchaser or other transferee to exploit the *intangible property*. If the rights are so restricted, the *identified region* comprises those Jurisdictions and the Adjusted Revenues are allocated to each of those Jurisdictions in proportion to *final consumption expenditure*.

2471. The *regional allocation key* is used in priority for contracts with *specified large intangible property customers*, recognising that there may be cases where a contract limits the rights of the licensee to exploit the intangible property to particular Jurisdictions, for example, as a way for the Covered Group to manage the protection of its underlying *intellectual property* rights. The *regional allocation key* is also used in priority for *intangible property* contracts where the *intangible property* supports a *location-specific service* recognising that in those cases the Covered Group is more likely to be in a position to tie the Adjusted Revenues to an *identified region*. There is no positive obligation to use the *regional allocation key* in cases where the *intangible property* contract is not a contract with a *specified large intangible property customer* and the *intangible property* does not support a *location-specific service*. This approach is designed to limit the burden of compliance for less valuable *intangible property* customer relationships that do not relate to *location-specific services*.

2472. As the *regional allocation key* is an *allocation key* within the meaning of Article 6(3)(c), the *regional allocation key* will only be considered a *reliable method* after the Covered Group has taken reasonable steps to identify enumerated indicators and has been unable to do so with respect to some portion of Adjusted Revenues, and after the application of the knock-out rule, as set out in Article 6(3)(a)(iii)(C).

2473. The reasonable steps requirement is discussed above. With respect to the knock-out rule, and as noted in the discussion on the Article 6(3)(a)(iii), the knock-out rule is treated as automatically satisfied in the context of the *regional allocation key*, by virtue of the identification of the *identified region*.

2474. In practice, the review of information necessary to apply the *regional allocation key* would take place at the same time as the review to identify the contracts respect of which the licence fee / royalty / other consideration was tied to the Adjusted Revenues earned by the licensee or transferee, and those *intangible property* contracts where the Covered Group had significant control rights. In other words, in fulfilling the reasonable steps requirement, the Covered Group would identify the contracts in respect of which diligence was required to seek *reliable indicators*. Where no *reliable indicators* are identified, the Covered Group should review the contract to understand whether a regional restriction applied to confirm whether the *regional allocation key* should be used. This means that when the Covered Group evaluates its *intangible property* contracts to identify those where there is a revenue share and where it has significant control, it should also identify which of those contracts include jurisdictional or regional restrictions.

Box 79. Examples – Regional allocation key for intangible property

The following examples illustrate the relevance of the *regional allocation key* for *intangible property*.

Example 1

The Covered Group has a small number of *intangible property* contracts (fewer than 100). It licenses *intangible property* that is related to a finished good. This is a brand that is attached to clothing. The Covered Group has licensed the brand to a regional distributor, and the contract provides that the distributor is entitled to exploit the brand in Jurisdictions A, B and C. That is the only *intangible property* contract that the Covered Group has with the regional distributor. The licensee pays a fixed fee upfront of EUR 25 million and is one of the top 200 *intangible property* customers for the Period, and as such, for that Period, the licensee is a *specified large intangible property customer* of the Covered Group. The contract does not require any reporting by the licensee of sales made in each Jurisdiction. The Covered Group does not have authority over the production or distribution chain used by the distributor. While the Covered Group does not have enumerated indicators to source Adjusted Revenues in the precise proportions to each Jurisdiction, it does have sufficient reliable information to use the *regional allocation key*. The Adjusted Revenues are sourced to Jurisdictions A, B and C in proportion to their respective shares of *final consumption expenditure*.

Example 2

A Covered Group licenses the patented formula of a successful drug to a third party that is entitled to exploit the patent globally. The licence generates substantial Adjusted Revenues for the Covered Group and the licensee is one of its *specified large intangible property customers*. The Covered Group is entitled to a royalty that fluctuates depending on the sales made by the licensee. Under the terms of the licence, the licensee is required to report the underlying sales information relating to the licensee's sales of the drug, on a region-by-region basis. The Covered Group uses the sales information to verify the level of remuneration received. Given that the Covered Group has access to such information (whether on request or automatically) as part of the contractual arrangement, the reasonable steps requirement means that the Covered Group should obtain and use that information for the purpose of revenue sourcing. Although the Covered Group does not receive a Jurisdiction-by-Jurisdiction breakdown of the licensee's sales, it can approximate those sales using the regional sales information and the *regional allocation key*.

2475. The *global allocation key* applies in three situations. First, to contracts with *specified large intangible property customers* where no regional restriction is imposed on the licensee's or transferee's right to use the *intangible property*. Second, to *intangible property* contracts where the *intangible property* supports a *location-specific service* but no regional restriction is imposed on the licensee's or transferee's right to use the *intangible property* (expected to be limited in practice). The third situation is in respect of all other *intangible property* contracts (i.e. those that are not with *specified large intangible property customers* and that do not support *location-specific services*).

2476. The *global allocation key* means that the Adjusted Revenues from *intangible property* are apportioned to all Jurisdictions in proportion to their respective shares of *final consumption expenditure*. Provided the Covered Group has followed the reasonable steps requirement and is not required to apply the *regional allocation key*, then no negative inference should be drawn where a Covered Group uses the

global allocation key to source Adjusted Revenues from *intangible property* used to support a service in such circumstances.

2477. If the Covered Group is using the *global allocation key*, then it must also apply the knock-out rule, as required by Article 6(3)(a). This is the same concept as discussed above for the tail-end revenues from the sale of finished goods through an independent distributor (see paragraph 2206 above), for components (see paragraph 2234) and for other services (see paragraph 2424 above). The knock-out rule would apply in cases where the Covered Group knows, based on law or regulation or documented structural commercial impediment that the finished good, or services supported by the *intangible property* should not be used in a Jurisdiction. However, given the Covered Group will only be applying the *global allocation key* in cases where it is expected to have limited visibility over the licensee's or transferee's use of the *intangible property*, where it is not required to use the *regional allocation key* and that information about the use of the service that is supported by that *intangible property* is further removed, it is recognised that it may still be challenging to apply the knock-out rule.

2478. See also discussion of the *component allocation key* in the context of components for an example of the mechanical application of the *allocation key* and the knock-out rule.

Box 80. Examples – Knock-out rule for intangible property

The following examples illustrate the application of the knock-out rule in the context of *intangible property*.

Example 1

The Covered Group licenses *intangible property* that supports a service, by providing copyrighted computer code that is used by businesses to develop their own cloud and software business. The license does not specify a limitation on the Jurisdictions in which the licensee may ultimately exploit the copyrighted computer code. However, because of limited intellectual property law protection in Jurisdiction A, the senior management decided that it should protect the Covered Group, and instructed its operational team to enter into subsequent agreements with all of its licensees of *intangible property* that they would not exploit the computer code in Jurisdiction A. The *global allocation key* is applied but removing Jurisdiction A from the allocation.

Example 2

The Covered Group licenses music to a range of international customers. The contracts do not provide for any restriction on the Jurisdictions where the music can be played, and the Covered Group does not have any reporting, revenue share or control over the use of the music in the advertisements. However, music is banned in Jurisdiction B, and regulatory requirements mean that the playing of music in Jurisdiction B is likely to attract a fine or sanction. The *global allocation key* is applied, but Jurisdiction B is removed from the allocation.

Overview – Intangible property not otherwise covered

2479. Annex D Section 4(3)(a)(i) and (b) outline the indicators for sourcing Adjusted Revenues from *intangible property* that is not related to a finished good or component and does not support the provision of a service or digital content. These are catch-all categories, to ensure that all Adjusted Revenues from

intangible property can be sourced. They are expected to be relatively limited categories. These are cases where the very nature of the *intangible property* means that there could not be an identifiable finished Good, component, service, or digital content. The Covered Group would be required to demonstrate why the *intangible property* could not be related to a finished good or component nor support a service or digital content as defined above.

Box 81. Examples – Intangible property not otherwise covered

The following examples illustrate when *intangible property* is and is not included in this category:

Example 1

The Covered Group is a pharmaceutical company. It licenses *intangible property* that is at an early stage of development. The drug is being used in clinical trials, but no marketing authorisation has been granted in respect of the drug in any Jurisdiction. It is therefore *intangible property* that is not at a stage where it can be related to a finished good or component. Once a marketing authorisation is issued the *intangible property* will be considered to be capable of producing saleable products and the Adjusted Revenues should be considered Adjusted Revenues from *intangible property* that relates to a finished good and the rule in Article 7(1)(a) should apply.

Example 2

The Covered Group is a pharmaceutical company. It licenses the right to use an active ingredient which is at research and testing stage, for which it will receive a milestone payment of EUR 10 million once a marketing authorisation is received in Region A. The research and development is undertaken at different clinical research sites internationally. A marketing authorisation is provided for Region A. At that point, the Adjusted Revenues (including the milestone payment) are considered to be derived from *intangible property* related to finished goods and should be sourced to the Jurisdictions comprising Region A.

2480. The sourcing rule is the Jurisdiction of use of the *intangible property*. As is the case for other services, this can be a challenging concept to apply. Given that there could be no final customer of a finished good or service, the Jurisdiction of use for this purpose refers to the Jurisdiction the licensee, purchaser or other transferee uses the *intangible property* in their own business. For example, where a patented formula for a pharmaceutical ingredient is licensed and that formula is not related to a finished good or component, the Jurisdiction of use will typically be the location of the research and development centres of the licensee where that licensee is conducting its work to test whether it is feasible to incorporate the ingredient into a new product.

2481. The rules relating to *intangible property* not otherwise covered are therefore split into two sub-categories: the first deals with contracts with *specified large intangible property customers* (paragraph 3(a)) and the second deals with all remaining contracts (paragraph 3(b)). The reason for splitting the *intangible property* not otherwise covered into two sub-categories is to balance the burdens and rewards from requiring additional diligence for contracts with larger customers falling within this category.

Paragraph 3

Indicators – Intangible property not otherwise covered – specified large intangible property customers

2482. Annex D Section 4(3)(a)(i) sets out the indicators which could be used for contracts with *specified large intangible property customers* where the *intangible property* is not related to a finished good or component and does not support a service or digital content.

2483. *Specified large intangible property customer* is defined in Annex D Section 7 as a customer from which Adjusted Revenues from *intangible property* are derived and where those Adjusted Revenues exceed EUR 20 million in a Period and the customer is one of the largest 200 *intangible property* contracts of the Covered Group by Adjusted Revenues. The *intangible property* contracts that the Covered Group has must be aggregated on a per customer basis to determine the *specified large intangible property customers*. The term *specified large intangible property customer* also includes any customer with which the Covered Group has an *intangible property* contract and the Adjusted Revenues from the licensing, sale or other alienation of *intangible property* to that customer exceed EUR 100 million in a Period. This approach is aligned with the reasonable steps requirement that applies to other parts of the section.

2484. If the Covered Group had no *intangible property* customers from which it derived EUR 20 million in a Period, then they do not apply the rule for *specified large intangible property customers*, and would proceed to paragraph 3(b). If the Covered Group had 350 *intangible property* customers from which it derived more than EUR 100 million in a Period where the *intangible property* under each contract did not relate to a finished good or component or support a service or digital content, then paragraph 3(a) would apply to the Adjusted Revenues derived from all 350 customers.

2485. To apply this rule, the first step is to identify the *intangible property* contracts with *specified large intangible property customers*. The mechanism for doing so must be documented so that it can be available for review by tax administrations.

2486. There is one enumerated indicator listed in this paragraph 3(a)(i). This is the Jurisdiction identified in the contract or any other commercial documentation as the Jurisdiction where the *intangible property* will be used.

2487. The use of these enumerated indicators is subject to the requirement that they be “reliable indicators”. This means that the information must credibly indicate the Jurisdiction of use of the *intangible property* and must be verifiable as provided in Article 6(3)(b)(i)).

Box 82. Example – Place of use and reliable indicators for specified large intangible property customers

The following example illustrates the place of use and the application of *reliable indicators* in this context of *specified large intangible property customers*.

The Covered Group is a pharmaceutical company. It licenses the right to use an active ingredient which is at research and testing stage, for which it receives a milestone payment of EUR 50 million on the completion of successful clinical trials. The ingredient has not yet received marketing authorisation in any market, and as such this is *intangible property* covered by paragraph 3 as there is no finished good related to the *intangible property* and no service supported by the *intangible property*. As the Adjusted

Revenues received from the licensee exceed EUR 20 million and it is one of the Covered Group's largest 200 intangible property customers by Adjusted Revenues for the Period, the licensee is a *specified large intangible property customer* and Covered Group must take reasonable steps to apply the enumerated indicators in paragraph 3(a). The Covered Group reviews the contract and commercial documentation. This includes information on the place where the licensee is performing the scientific research, experiments, test and trials. This information is an enumerated *reliable indicator* because it is consistent with the sourcing rule (which is the place of use of the *intangible property*), and the information has been collected for commercial purposes.

2488. It is always the case that the Covered Group may use another *reliable indicator* under Article 6(3)(b)(i). The application is not mandatory, but where the Covered Group has reliable information other than information in the contract or other commercial documentation, it may be able to use it.

Box 83. Example – Another reliable indicator for specified large intangible property customers

The following example illustrates the principles of another *reliable indicator* in the context of *specified large intangible property customers*.

The Covered Group is a pharmaceutical company. It licenses the right to use an active ingredient to a subsidiary of another large pharmaceutical group which is at research and testing stage, for which it receives a milestone payment of EUR 50 million on the completion of successful clinical trials. This is the Covered Group's only *intangible property* contract with that subsidiary. The ingredient has not yet received marketing authorisation in any market, and as such this is *intangible property* covered by Article 7(1)(e)(iii) as there is no finished good related to the *intangible property* and no service supported by the *intangible property*. As the Adjusted Revenues received from the licensee exceed EUR 20 million and it is one of the Covered Group's largest 200 *intangible property* customers by Adjusted Revenues for the Period, the licensee is a *specified large intangible property customers*. During the Period, the licensee opens a global centre of excellence for research and development. A number of scientific research journals report that all of the licensee's research and development is now undertaken at the research and development centre. As the information produces results that are consistent with the sourcing rule (in that it identifies the place of use of the *intangible property* by the licensee) and is verified by third parties (the scientific research journals) that collect the information for their own commercial reasons (content in their publication), it can be treated as another *reliable indicator* for purposes of Article 6(3)(b)(i).

2489. Article 6(3)(b)(ii) provides that the Covered Group may use an alternative *reliable indicator*. The application of an alternative *reliable indicator* is also not mandatory.

Allocation key – Intangible property not otherwise covered – specified large intangible property customers

2490. Annex D Section 4(3)(a)(ii) provides that for remaining Adjusted Revenues to be sourced using the *aggregate headcount allocation key*. As the *aggregate headcount allocation key* is an *allocation key* within the meaning of Article 6(3)(c), the prerequisites for it to be a *reliable method* in accordance with Article 6(3)(a)(iii) are that the use of the *allocation key* is expressly permitted in the rule (which is the case

for this rule); that the Covered Group demonstrates that it has taken reasonable steps to identify an enumerated indicator and concluded that no such *reliable indicator* is available; and that the knock-out rule is applied. The latter two are discussed in turn.

2491. Reasonable steps means, in this context, that the Covered Group must review the information contained in the contract, as well as review information held by a client account manager (if any), to determine whether it has any reliable information on the place of use of the *intangible property* is in its possession. It does not require that the Covered Group contact the customer specifically to ask for information on the place of use of the *intangible property*. It does not require seeking to amend an existing contract to add a new reporting obligation, nor to insert such a requirement in a future contract with the customer. While a Covered Group is not precluded from taking measures beyond the reasonable steps described, should it wish to do so, there can be no negative inference in respect of a Covered Group that met the reasonable steps requirement and then proceeded to use the *allocation key* in respect of any remaining Adjusted Revenues. However, it is recognised that for many Covered Groups it is not commercial practice for place of use of *intangible property* to be recorded in a contract or for customers to provide any reporting on the place of use. This may be because the place of use of the *intangible property* can be conceptually difficult to identify. It may also be because the information is not required by the Covered Group entering the *intangible property* contract, or such information may be commercially sensitive for the customer.

2492. A Covered Group that applies the *aggregate headcount allocation key* is also required by Article 6(3)(a)(iii) to apply the knock-out rule. However, given the nature of *intangible property* that is not yet commercialised, and the fact that after having taken the steps above in respect of the contracts with *specified large intangible property customers* there are still no *reliable indicators* available, it may still be challenging to apply the knock-out rule. This may mean that the *aggregate headcount allocation key* applies to more than 100 Jurisdictions.

2493. The *aggregate headcount allocation key* operates as described in paragraph 2390 onwards. It provides that the Adjusted Revenues should be allocated in proportion to the aggregated employee headcount for each Jurisdiction as reported in the aggregated country-by-country reporting statistics of the UPE Jurisdiction of the licensee, purchaser or other transferee. This information will be provided by the OECD. The Covered Group is not required to determine whether the customer did in fact file a country-by-country report, nor is the Covered Group required to determine the actual jurisdictional breakdown of the customer's employees.

2494. To apply the *aggregate headcount allocation key*, the Covered Group must know that the customer is a member of a broader international group and where the UPE of that group is based. Often this will be straightforward but, in some cases, it may not be. Where this rule applies, the Covered Group is required to make reasonable efforts to determine whether the *specified large intangible property customer* is part of a wider group and if so, where the UPE of the customer is resident. As set out in paragraph 2403, this requires it to check the information that it has in its possession, and other information that is accessible to the Covered Group and to document its research process. The Covered Group is not required to ask the customer, nor is the Covered Group expected to undertake involved research of public sources to understand whether the customer is a member of a wider group.

2495. If the Covered Group can identify the UPE, then it may use information on the UPE's headquarters, principal place of business, or place of incorporation to apply the *aggregate headcount allocation key*. If after the application of reasonable efforts, no information is available, the Covered Group may assume the UPE is resident in the same Jurisdiction as the customer. Paragraphs 2405 through 2407 outline how the *aggregate headcount allocation key* is applied when country-by-country reporting data is not available or is not fully disaggregated by Jurisdiction.

Indicators – Intangible property not otherwise covered – other intangible property contracts

2496. Annex D Section 4(3)(b) sets out the indicators which could be used for *intangible property* contracts that are not with *specified large intangible property customers* where the *intangible property* is not related to a finished good or component and does not support a service or digital content.

2497. The indicators permitted for this situation are information contained in the contract or commercial documentation on the place of use; the location of the licensee or transferee; the billing address of the licensee or transferee; another *reliable indicator*; and an alternative *reliable indicator*.

2498. The use of these indicators is subject to the reliability tests in Article 6(3)(b)(i). For example, there may be cases where the Covered Group has actual knowledge that the billing address is not the place of use of the *intangible property* and in those cases, it would not be considered to produce results that are consistent with the sourcing rule and therefore would not be reliable as required in Article 6(3)(b).

Box 84. Examples – Place of use and reliable indicators for intangible property not otherwise covered

The following examples illustrate the place of use and the application of *reliable indicators* in this context.

Example 1

The Covered Group is a pharmaceutical company. It licenses the right to use an active ingredient which is at research and testing stage, for which it receives a milestone payment of EUR 10 million on successful completion of a development phase. This contract is the only *intangible property* contract the Covered Group has with that licensee. The ingredient has not yet received marketing authorisation in any market, and as such this is *intangible property* covered by Article 7(1)(g) as there is no finished good related to the *intangible property* and no service supported by the *intangible property*. The Covered Group reviews the contract and commercial documentation. This includes information on the place where the licensee is performing the scientific research, experiments, test and trials. This information is a *reliable indicator* because it is consistent with the sourcing rule (which is the place of use of the *intangible property*), and the information has been collected for commercial purposes.

Example 2

The facts are the same as Example 1, except that there is no information in the contract or commercial documentation on the location where the scientific research, experiments, test and trials are conducted. The Covered Group has a billing address for the licensee and uses that address to raise the invoice to the licensee. The billing address is a *reliable indicator* because it is consistent with the sourcing rule (which is the place of use of the *intangible property*), and the information has been used for commercial purposes (raising the invoice).

Example 3

The facts are the same as Example 2, except that, because of the sensitive nature of the *intangible property*, it is commercial practice for the Covered Group to conduct some due diligence on the licensee, as part of efforts to protect the Covered Group from reputational risk. In the course of doing so, the relevant employee notices that the billing address is in a Jurisdiction that the Covered Group has never dealt with before, and which does not match other information about the licensee's operations. The billing address does not appear to be a *reliable indicator*, because they are not consistent with the

sourcing rule, which is the place of use of the *intangible property* and which appears to be unconnected with the other operations of the licensee. Although the requirements of reliability do not require the Covered Group to actively investigate every billing address (note Example 2), because the Covered Group is already undertaking this information gathering in the course of its commercial operations, the information should be used. In this case, the billing address cannot be used, and the Covered Group must seek other information on the place of use of the *intangible property*. Given that the Covered Group is already undertaking due diligence on the licensee, it knows that the licensee has research facilities in Jurisdictions A and B. The facilities appear to be the same size and are marketed as having equal importance in the licensee's operations. The Covered Group sources the Adjusted Revenues in equal proportions to Jurisdiction A and B. Because this information is consistent with the sourcing principle, and the information was obtained for the Covered Group's commercial purposes, the information meets the conditions of Article 6(3)(b)(i) and is another *reliable indicator*.

Section 5 – User Data

Paragraph 1

Overview

2499. Article 7(1)(f) and Annex D Section 5 provide revenue sourcing rules for user data. This category captures business models that monetise user data generated on a digital interface by selling, licensing or otherwise alienating it to unrelated third parties. It means that the Covered Group is earning a specific stream or Adjusted Revenues from providing the rights to the user data to another party as a business; it does not relate to cases where the business is using user data in improving its own commercial success.

2500. User data can be generated by users and provided to a Covered Group, or can be collected by the Covered Group based on the user's observed behaviour and preferences.

2501. User data includes information such as a user's habits, spending, location, environment, usage of services, hobbies, or personal interests, including anonymised and aggregated data (including geolocation information and user traffic levels). The data may be collected as raw data by the Covered Group (e.g. the manufacturer / seller of a home heating system collecting data about energy use, or a social media company collecting data about its users) or it may be acquired from another business.

2502. The term user means any person accessing a service, but does not include the provider of the service (or a Group Entity of the same Covered Group as that provider) or employees of the provider.

Sourcing rule

2503. Article 7(1)(f) states the revenue sourcing principle which is that Adjusted Revenues from sale, licensing or other alienation of user data are sourced to the location of the user that is the subject of the data. In this way, the sourcing rule reflects the approach for advertising as the Adjusted Revenues are sourced to the Jurisdiction(s) where the user is located, and not to the location of the business that pays for the data. The reference to "licensing, sale, or other alienation" ensures that all forms of Adjusted Revenues generated from the exploitation of user data are captured, without creating any inference as to

whether such *transactions* are in fact in the form of a sale, license or other legal arrangement; provided, however, that this only applies to the extent such receipts qualify as Adjusted Revenues.

2504. Annex D Section 5(1) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from user data.

Paragraph 2

Indicators

2505. Annex D Section 5(2) sets out the indicators which could be used for user data. These are the same as those used for online advertising, i.e., the user profile information of the user; the geolocation of the device of the user through which the data is transferred; or the IP address of the device of the user through which the data is transferred. A discussion on each of the indicators is included in paragraphs 2261 through 2264. The discussion on how the reliability tests applies to IP addresses is included at paragraphs 2266 and 2267.

2506. As per the definition of *reliable indicator* in Article 6, another *reliable indicator* or an alternative *reliable indicator* could be used if there is another type of information that identifies the location of the user.

Box 85. Example – Another reliable indicator for user data

The following example illustrates the principles of another *reliable indicator* in the context of user data.

The Covered Group operates an online marketplace that sells a wide range of consumer products. It sells data to a new entrant in the wearable technology market aggregating the user data it has on consumer buying preferences in region A. It compiles the data based on a combination of the delivery addresses and billing information used by purchasers of wearable technology through its platform. Because this information is consistent with the sourcing rule (in that it identifies the location of the users), it is based on information collected for commercial purposes (in that it is the information used to complete *transactions* on the site), it meets the definition of a *reliable indicator* in Article 6(3)(b), and it is another *reliable indicator* under Article 6.

Section 6 – Immovable property

Paragraph 1

Overview

2507. Article 7(1)(g) and Annex D Section 6 provide revenue sourcing rules for *immovable property*. To the extent that Adjusted Revenues derived from sale, lease or other alienation of *immovable property* are included in the Covered Group's Adjusted Revenues (as determined by the relevant accounting standard), they are also sourced for the Convention.

2508. *Immovable property* is a defined term. Adjusted Revenues from *immovable property* could include rental income, sale of real estate, or Adjusted Revenues derived from the sale of a right to explore or exploit a natural resource (provided it was not excluded under the *extractives activities*, for example, a right to exploit an agricultural area). It would not include the Adjusted Revenues or gains from a *financial asset* which had as its underlying basis an interest in *immovable property* (such as a mortgage-backed security). These assets, if they are included as Adjusted Revenues, would be sourced all together with other non-customer revenues in Article 7(2) (discussed in paragraph 337). In some Jurisdictions, ownership of apartments and other premises is evidenced as share ownership in a company. To the extent sales of those apartments or other premises or revenue earned from leasing those apartments or premises is recognised as comprising Adjusted Revenues, it too would be regarded as Adjusted Revenues derived from *immovable property*.

Sourcing rule

2509. Article 7(1)(g) states the revenue sourcing principle, which is the location of the *immovable property*.

2510. Annex D Section 6(1) refers to the rules that apply for the purposes of identifying a *reliable method* that may be used to source Adjusted Revenues derived from *immovable property*.

Paragraph 2

Indicators

2511. Annex D Section 6(2) sets out the indicators which could be used for *immovable property*, being the Jurisdiction of the address of the property or the Jurisdiction granting the right to exploit the *immovable property*. As per the definition of *reliable indicator* in Article 6, another *reliable indicator* or an alternative *reliable indicator* could be used if there is another type of information that identifies the location of the *immovable property*.

Section 7 – Definitions relevant to Article 6, 7 and Annex D

General definitions

2512. Annex D Section 7(a) defines “final consumption expenditure” as the *final consumption expenditure* value for the most recent calendar year that does not end after the Period ends, expressed at current United States dollars as published by the United Nations for a Jurisdiction, or if no such value is available for any of the five calendar years that immediately precede the Period, the value in current United States dollars as published by the World Bank. If no such value is available for a Jurisdiction for any of the five calendar years that immediately precede the Period, an approximation is calculated based on that Jurisdiction’s *gross national income* or Gross Domestic Product (in that order and based on availability) and the simple average of the ratio of *final consumption expenditure* to *gross national income* or Gross Domestic Product for all Jurisdictions for which *final consumption expenditure* was available. It is a macroeconomic proxy that is used as a back-up proxy for certain *allocation keys*.

2513. Annex D Section 7(b) defines “gross national income” as the *gross national income* value for the most recent calendar year that does not end after the Period ends, expressed at current United States dollars as published by the United Nations for a Jurisdiction, or if no such value is available for any of the five calendar years that immediately precede the Period, the value in current United States dollars as

published by the World Bank. It is a macroeconomic proxy that is used as a back-up proxy for certain *allocation keys*.

2514. Annex D Section 7(c) defines “identified region”. The meaning of *identified region* is discussed in paragraph 2202.

2515. Annex D Section 7(d) defines “immovable property”. The meaning of *immovable property* is discussed in paragraph 2508.

2516. Annex D Section 7(e) defines “intangible property”. The meaning of *intangible property* is discussed in paragraph 2428.

2517. Annex D Section 7(f) defines “location-specific services”. The meaning of *location specific services* is discussed in paragraphs 2241.

2518. Annex D Section 7(g) defines “specified large customer”. The meaning of *specified large customer* is discussed in paragraph 2375 onwards.

2519. Annex D Section 7(h) defines “specified large intangible property customer”. The meaning of *specified large intangible property customer* is discussed in paragraph 2467 onwards.

2520. Annex D Section 7(i) defines “transaction”. The meaning of *transaction* is discussed in paragraph 233 onwards.

Paragraphs 10 to 19

Allocation keys

2521. Annex D Section 7(j) defines “aggregate headcount allocation key”. The meaning of *aggregate headcount allocation key* is discussed in paragraph 2391 onwards.

2522. Annex D Section 7(k) defines “cargo air transport allocation key”. The meaning of *cargo air transport allocation key* is discussed in paragraph 2323 onwards.

2523. Annex D Section 7(l) defines “cargo non-air transport allocation key”. The meaning of *cargo non-air transport allocation key* is discussed in paragraph 2344 onwards.

2524. Annex D Section 7(m) defines “component allocation key”. The meaning of *component allocation key* is discussed in paragraph 2237.

2525. Annex D Section 7(n) defines “excess tail-end revenues allocation key”. The meaning of *excess tail-end revenues allocation key* is discussed in paragraph 2215 onwards.

2526. Annex D Section 7(o) defines “global allocation key”. The meaning of *global allocation key* is discussed in paragraph 2213.

2527. Annex D Section 7(p) defines “lower income jurisdiction allocation key”. The meaning of *lower income jurisdiction allocation key* is discussed in paragraph 2207 onwards.

2528. Annex D Section 7(q) defines “passenger air transport allocation key”. The meaning of *passenger air transport allocation key* is discussed in paragraph 2314 onwards.

2529. Annex D Section 7(r) defines “passenger non-air transport allocation key”. The meaning of *passenger non-air transport allocation key* is discussed in paragraph 2335.

2530. Annex D Section 7(s) defines “regional allocation key”. The meaning of *regional allocation key* is discussed in paragraph 2202 onwards.

2531. Annex D Section 7(t) defines “service allocation key”. The meaning of *service allocation key* is discussed in 2419 onwards.

Annex E – Supplementary provisions for Section 1 of Part V

Section 1 – Transition periods

Paragraph 1

2532. In order to aid newly in-scope Covered Groups and *covered segments*, a more accommodating application of the revenue sourcing rules will apply, recognising the challenges Groups and *disclosed segments* are likely to face in building new systems to comply with Amount A, in particular with respect to revenue sourcing, and the inevitable learning and refinements that will be needed. There are two aspects to this accommodation. One aspect of this transitional approach is to provide the ability for a Covered Group / *covered segment* to have access to *allocation keys* in the short-term, which is provided for in paragraph 2. The second aspect is the “soft landing” which provides a Group / *disclosed segment* with a period of learning and refinement once it starts applying the ordinary revenue sourcing rules. It is this soft landing which is contained in paragraph 1.

2533. The purpose of the transitional rules is to allow sufficient time to enable Covered Groups to develop the systems required for complying with the revenue sourcing rules, while also ensuring that revenue can be sourced in the period until such systems are operational. Paragraph 1 established that Parties will provide that for Covered Groups and *covered segments* during the *revenue sourcing transitional period*, no adjustment to their revenue sourcing will apply provided *reasonable measures* to apply the rules have been taken.

Paragraph 2

2534. Paragraph 2 provides that Parties shall allow for an *initial revenue sourcing transition phase* for the first years of application of Amount A. This means that during the *initial revenue sourcing transition phase*, for all categories of Adjusted Revenues, the Covered Group is allowed to use an *allocation key* as a way to comply with its revenue sourcing obligations (which in most cases will be the *global allocation key*), notwithstanding the requirement of applying a *reliable method* in Article 6. As noted above, the soft landing provides a Covered Group with a period of learning and refinement once it starts applying the ordinary revenue sourcing rules. The *initial revenue sourcing transition phase* lasts for, at most, the first three Periods that the MLC is in effect.

2535. The provision of this transitional rule is to allow sufficient time to enable Covered Groups to develop the systems required for complying with the revenue sourcing rules, while also ensuring that revenue can be sourced in the period until such systems are operational.

2536. Paragraph 2 requires that Parties provide that the Covered Group is permitted to use the relevant *allocation key* for the *initial revenue sourcing transition phase*.

2537. Paragraph 2 also obliges Parties to provide that the Covered Group is able to use the methods described in paragraph 2(a) through (e) (which are *allocation keys*, apart from Adjusted Revenues from the sale of finished goods through an independent distributor), without having to meet the conditions set out in Article 6. This means that it is permitted to use an *allocation key* even where one is not otherwise authorised by the rule itself; it is not required to demonstrate that it has taken reasonable steps to obtain enumerated *reliable indicators*; and it would not be required to apply the knock-out rule.

2538. Paragraph 2 is permissive. It means that the use of the *allocation key* is not required in this period but is available for any or all of the Covered Group's revenue sourcing. This also means that it may still choose to seek *reliable indicators* before using the *allocation key*, and it may choose to apply the knock-out rule.

2539. Subparagraphs (a) through (e) set out which method or *allocation key* that the Parties shall permit to be used for each category of Adjusted Revenues. This means that the Covered Group would be required to categorise the Adjusted Revenues in order to apply the relevant keys.

2540. Paragraph 2(a)(i) includes an anti-avoidance rule which adjusts how the allocations in paragraph 2(a) for Adjusted Revenues from finished goods sold through an independent distributor are made. It applies where the Covered Group knows or has a reasonable basis to conclude that the finished goods sold through an independent distributor are primarily delivered outside the Jurisdiction of the independent distributor. In those circumstances, the Covered Group must allocate the Adjusted Revenues using the *regional allocation key* if it can identify an *identified region* where the finished goods were delivered to final customers. If it cannot identify such an *identified region*, it must source the Adjusted Revenues using the *global allocation key*.

2541. Paragraph 2(a)(ii) provides that Parties allow the allocation method for finished goods sold through independent distributors. This 85/5/10 allocation, which is based on sourcing of 85 per cent of the unsourced Adjusted Revenues to the location of the independent distributor; 5 per cent to Lower Income Jurisdictions (the existing tail-end revenues allocation); and 10 per cent to the other remaining Jurisdictions. The rule also prevents double counting, for example, when the independent distributor is also a Lower Income Jurisdiction, in which case it only receives the allocation under the rule for the independent distributor.

Box 86. Example – 85/5/10 rule

The following example illustrates the application of the default 85/5/10 rule for Adjusted Revenues from finished goods through independent distributors.

The Covered Group has EUR 1 billion in Adjusted Revenues received from the sale of finished goods sold through independent distributors for which it does not have information available to apply a *reliable indicator*. Based on the 85/5/10 rule, EUR 0.85 billion is allocated based on the location of the independent distributors. This means that the Covered Group looks at each Jurisdiction in which its independent distributors are located, to add the Adjusted Revenues it receives from those independent distributors in that Jurisdiction and multiplies this by a factor of 0.85. The next EUR 0.05 billion is allocated to Lower Income Jurisdictions that do not have an independent distributor. The last EUR 0.1 billion is allocated to the remaining Jurisdictions, that are not also the location of independent distributors or Lower Income Jurisdictions.

2542. In the case paragraph 2(a)(ii) cannot apply, for example when the Covered Group has no information on the location of the independent distributors, paragraph 2(b) provides that Parties allow that Adjusted Revenues from finished goods sold through independent distributors will be sourced using the *global allocation key*.

2543. Subparagraph (c) obliges that Parties provide the *allocation key* for components, which is the *component allocation key*.

2544. Subparagraph (d) requires that Parties provide the *allocation key* for other services, which is the *service allocation key*.

2545. Subparagraph (e) requires that Parties provide the *allocation key* for all other cases, which is the *global allocation key*.

Paragraph 3

2546. Unlike for the exclusion of revenues and profits of a *qualifying extractives group*, no initial transition period providing for simplified reliance on financial statements has been proposed for the exclusion of revenues and profits in respect of *regulated financial institutions*. This is because the exclusion with respect to a Group containing one or more *regulated financial institutions* will not be associated with as significant IT system build requirements and is therefore considered simpler to apply. However, it is recognised that there may be certain factual determinations and matters of judgement for such Groups in applying the rules. For this reason, an *advance certainty review* process is also provided for Groups and *disclosed segments* conducting regulated financial services. As such, a three Period soft landing phase is provided in paragraph 3 for Parties to provide for a limited period of learning and refinement in the context of that certainty process.

Paragraph 4

2547. Paragraph 4 obliges that Parties provide a transition for *qualifying extractives groups* and for *disclosed segments* of *qualifying extractives groups*. As with revenue sourcing, the purpose of the transitional approach to the application of the rules for *qualifying extractives groups* is to allow sufficient time to enable Groups to develop the systems required for complying with the rules, while also ensuring that *qualifying extractives groups* can determine whether they are in scope of the rules for Periods until such systems are operational. It is also recognised that this transition period will provide additional time for tax administrations, particularly those from developing countries, to prepare to engage in the more detailed compliance review process.

2548. As is the case for revenue sourcing, there are two aspects to the transitional period. The first element is that the substantive rules on Amount A include an *initial extractives transition phase* for *qualifying extractives groups*. In the *initial extractives transition phase*, a *qualifying extractives group* may use the steps outlined in paragraph 5 instead of following the steps outlined in Article 3 (as modified by Annex C Section 3). The second element, contained in paragraph 4, is that for the *initial extractives transition phase* (to the extent it is needed) and the three consecutive Periods that immediately follow, provided a *qualifying extractives group* has taken *reasonable measures* in the application of the rules in Annex C Section 3, its application of the rules of Annex C Section 3 will be accepted by the Parties.

Paragraph 5

2549. The *initial extractives transition phase* is provided by paragraph 5, for the first six Periods of application of Amount A. During this time, the rules facilitate greater ability to rely on the *disclosed segment's* financial results, with less need to prepare bespoke calculations for purposes of the exclusion. The soft-landing phase lasts for the subsequent three Periods (or longer and up to a maximum of nine Periods, to the extent the Group has not applied the approach in the *initial extractives transition phase* in those first three Periods).

2550. The *initial extractives transition phase* in paragraph 5 is a simplified mechanism for demonstrating that a Group is not in scope of Amount A after applying the extractives exclusion. That is, the non-extractives part of the Group does not by itself meet either the revenue threshold or the profitability threshold when treated as independent of the extractives part of the Group.

2551. In a case where a Group would otherwise be a Covered Group because, taken as a whole, it meets the revenue threshold and profitability threshold in Article 3, then during the *initial extractives transition phase*, paragraph 5 requires Parties to provide a simplified way for the Group demonstrate that it either:

- a) does not meet the non-extractives revenue test (including when applying the approach in Annex E Section 2); or
- b) does not meet the non-extractives profitability test.

2552. In a case where a Group would otherwise be in scope of Amount A in connection with one or more *covered segments* only by virtue of Article 3, then during the *initial extractives transition phase*, paragraph 5 requires Parties to provide a simplified way for the Group demonstrate that it either:

- a) does not meet the non-extractives segment revenue test; or
- b) does not meet the non-extractives segment profitability test.

2553. There are three different simplification mechanisms that are required to be provided by Parties in paragraph 5. The Group may rely on the rule of paragraph 5 pursuant to any of the mechanisms that applies under the facts and circumstances, to elect which of these mechanisms is most relevant.

2554. The first simplification mechanism is contained in subparagraph (a). This requires Parties to provide that for the *initial extractives transition phase*, the limitation of the exclusion to revenues reported in the financial statements of an Entity or a Taxable Presence located in, the Jurisdiction where the *extraction* was undertaken does not apply when determining whether a *disclosed segment* is an *extractives segment*. This means that a *disclosed segment* meets the definition of an *extractives segment* provided that at least 75 per cent of the revenues reported in that *disclosed segment* are *extractives revenues* (e.g. revenues from *extractive products* or from products resulting from *qualifying processing* as defined in Annex C Section 3(3)(i) (referred to in the below examples as “Section 3(3)(i) revenues”), irrespective of whether those revenues were booked for financial accounting purposes in the Jurisdiction in which the *extraction* took place (referred to here as the “Jurisdiction of *extraction*”).

Box 87. Example 1 – Subparagraph (a)

Mining Group A reports the following *disclosed segments* in its Consolidated Financial Statements.

Year 1 (in million EUR)	Aluminium	Copper	Iron Ore
Section 3(3)(i) revenues, without applying Jurisdiction of <i>extraction</i> test	10,000	6,200	30,500
Other revenue	1000	500	5000
Total revenue	11,000	6,700	35,500
Section 3(3)(i) revenues as a percentage of Total revenue	91%	93%	86%
Revenue of the segment reported in the Consolidated Financial Statements	8,000	6,000	33,000

Disregarding whether revenue from each commodity was booked in the Jurisdiction of *extraction* of the associated *extractive product*, the revenue reported in each *disclosed segment* contains at least 75% from products resulting from *qualifying processing* that are within the scope of the exclusion.

Each of the above *disclosed segments* meets the definition of an *extractive segment* during the *initial extractives transition phase*.

The rules in Annex E Section 2(1)(a) provide that the Group can show it does not meet the non-extractives revenue test, by deducting from the Adjusted Revenues of the Group the revenues included in the Consolidated Financial Statements (i.e. third party revenues) that are earned by one or more *extractives segments*, to the extent that the result of this calculation demonstrates that the Group does not satisfy the non-extractives revenue test.

The Adjusted Revenues in the Consolidated Financial Statements is 47 billion. In this case, the Group can deduct the third-party revenues of the Iron Ore segment, which is an *extractives segment* as defined for the purpose of the *initial extractives transition phase*, from the revenue reported in Consolidated Financial Statements. That result (47 billion – 33 billion) is that the remaining Adjusted Revenues are 14 billion.

The Group does not need to continue to calculate the *non-extractives adjusted revenues*, as per the rules in Annex C Section 3 as it is already below the *non-extractives adjusted revenues* test. The Group is out of scope.

2555. The second simplification mechanism, contained in subparagraph (b), is the equivalent of the approach in subparagraph (a) as it applies to a *disclosed segment* but, instead, modified for purposes of the entity approach. This recognises that both approaches are valid in Annex C.

Box 88. Example 2 – Subparagraph (b)

Oil and Gas Group B has the following Entities. Entity 2 and Entity 3 are each resident in the Jurisdiction of *extraction*. Entity 1 is resident outside the relevant Jurisdiction of *extraction*. It also has a number of other entities that are engaged in manufacturing and renewables and are not *extractives entities*.

Year 1 (in million EUR)	Entity 1	Entity 2	Entity 3
Section 3(3)(i) revenues, without applying Jurisdiction of <i>extraction</i> test	15,000	1,500	42,000
Other revenue	1000	700	8000
Total revenue	16,000	2,200	50,000
Section 3(3)(i) revenues as a percentage of Total revenue	94%	68%	84%

Disregarding whether Adjusted Revenues were booked in the Jurisdiction of *extraction* of the associated *extractive product*, Entity 1 and Entity 3 meet the definition of an *extractives entity* during the *initial extractives transition phase*, as at least 75 per cent of their Adjusted Revenues relate to products

resulting from *qualifying processing* that are within the scope of the exclusion.

Entity 2 does not meet the test that at least 75 per cent of reported revenues are derived from products resulting from *qualifying processing* that are within the scope of the exclusion. Therefore, Entity 2 is not an *extractives entity*.

Assume the Group does meet the *non-extractives adjusted revenues* test. The Group then calculates the *non-extractives financial accounting profit (or loss)* under Annex C Section 3(2)(z)(ii). It does this taking the following steps.

The Group first identifies the *extractives entities* (i.e. those which earn 75 per cent or more of their revenues from extractives) and disregards these Entities for the purpose of the *non-extractives financial accounting profit (or loss)* calculation. It then calculates the *non-extractives financial accounting profit (or loss)* of the *non-extractives entities*. Provided none of these Entities' results are reported in an *extractives segment*, for such Entities, the *non-extractives entity profit (or loss)* is the pro rata portion of the Entity's profit as recorded in the Entity Financial Accounting Profit (or Loss), based on the proportion of *non-extractives adjusted revenues* to total revenues. The Group then identifies *mixed entities* (i.e. those which derive more than 25 per cent, but less than 75 per cent, of their revenues from extractives). Provided none of these Entities' results are reported in an *extractives segment*, for such Entities, the *non-extractives financial accounting profit (or loss)* is the Entity Financial Accounting Profit (or Loss), less the items related to extractives (e.g. *extractives revenues* and certain gains and losses, expenses directly or indirectly incurred in the conduct of *extractives activity* or the derivation of). The *non-extractives financial accounting profit (or loss)* when using the entity approach is reached by adding the *mixed entity profit (or loss)* of all *mixed entities* and the *non-extractives entity profit (or loss)* of all *non-extractives entities*.

The Group then retests the profitability of the non-extractives part of the Group under the non-extractives profitability test, using the *non-extractives adjusted profit before tax* and the *non-extractives adjusted revenues* of the Group (including both third party and intra-group revenues) to determine whether the *non-extractives pre-tax profit margin* exceeds 10 per cent.

2556. The third simplification mechanism, contained in subparagraph (c), requires Parties to allow the Group to calculate the *pre-tax profit margin of disclosed segments* based on the limited adjustments required in Annex C Section 4(8)(b). That is, the Group is not required to make any adjustments to remove *extractives revenues*. This is relevant where the Group has one or more *non-extractives segments*, and / or one or more *mixed segments* (noting that the rule in subparagraph (a) already provides an approach for an *extractives segment*), and where the margin of that segment is below 10 per cent (because the transition rules are a simplification only if it demonstrates that the Group is out of scope).

Box 89. Example 3 – Subparagraph (c)

Oil and Gas Group C reports the following *disclosed segments* in its Consolidated Financial Statements.

Year 1 (in million EUR)	Upstream	Chemicals	Refined oil products, power, and marketing
Revenue from commodity per section 3	40,000	5000	16,200

Other revenue	1000	20,500	15,050
Total revenue	41,000	25,500	31,250
Percentage of section 3(3)(i) commodities revenue	98%	20%	52%
Profit Margin per Annex C Section 4 rules (%)	46.4%	7.8%	1.40%

Assume that the Group meets the non-extractives revenue test. It therefore needs to apply the non-extractives profitability test.

Disregarding whether revenue from each product resulting from *qualifying processing* was booked in the Jurisdiction of *extraction*, the revenue reported in the Upstream Segment contains at least 75 per cent from products that are within the scope of the exclusion. It meets the definition of an *extractive segment* during the *initial extractives transition phase*. The Chemicals segment is a *non-extractives segment*. The Refined oil products, power and marketing segment is a *mixed segment*.

The approach in subparagraph (c) permits the Group to use the profit margin of each of the remaining *disclosed segments*, after making the adjustments in Annex C Section 4(8)(b).

The Group is applying the disclosed segment approach to calculating the *non-extractives financial accounting profit (or loss)*, in Annex C Section 3(2)(z).

First, the Group excludes the results in the Consolidated Financial Statements that are from the *extractives segment* (the Upstream Segment), using Annex C Section 3(2)(z)(i)(A).

It takes the result of that adjustment and applies the rules in Annex C Section 3 (2)(z)(i)(B) to the *non-extractives segment* (the Chemicals Segment). The *initial extractives transition phase* rule means that the Group does not need to make the adjustments to adjust for any *extractives revenues* reported in the segment. It only needs to make the adjustments required as per Annex C Section 4 (which includes the adjustment for *unallocated income* and *unallocated expenses* in Annex C Section 3(2)(z)(i)(B)(2), which are the same as those in Annex C Section 4).

It takes the result of that adjustment and applies the rules in Annex C Section 3(2)(z)(i)(C) to the *mixed segment* (the Refined oil products, power and marketing segment). The *initial extractives transition phase* rule in subparagraph (c) means that the Group does not need to make the adjustments to adjust for any *extractives revenues* reported in the *disclosed segment*. It only needs to make the adjustments required as per Annex C Section 4 (which includes the adjustment for *unallocated income* and *unallocated expenses* in Annex C Section 3(2)(z)(i)(C)(4), which are the same as those in Annex C Section 4).

On the basis of these calculations, the Group does not meet the non-extractives profitability test and is not in scope of Amount A.

Paragraph 6

2557. Paragraph 6 requires Parties to ensure that where, as a result of a *comprehensive certainty outcome*, a Group is required to amend its application of Article 4 or 12 (i.e. either an increase in the tax due to a market jurisdiction or decrease in the relief due from a *relieving jurisdiction*), then a Party to the

Convention would not apply any interest or administrative penalties imposed under its domestic tax law for the failure of an Entity to meet its tax payment obligations under the Convention in relation to the required amendment. This applies in relation to liabilities of the Designated Payment Entity and claims for double tax relief by *relief entities*. As paragraph 6 does not deal with the issue of whether interest on tax refunds should be paid to taxpayers in the case of a decrease in the tax due to a market jurisdiction or an increase in the relief due from a *relieving jurisdiction*, this is a matter for the domestic law of each Party.

2558. This transition rule will apply for the duration of the *revenue sourcing transitional period* and will only apply where the Covered Group has taken *reasonable measures* in its application of the Amount A rules. The purpose of the transition rule is to aid Covered Groups in their application of the Amount A rules in the early years of the entry into force of the Convention. Examples of what constitutes *reasonable measures* will be agreed as part of the future guidance on the implementation of Amount A. However, if the Covered Group has failed to lodge its Amount A Tax Return and Common Documentation Package on time or to failed to meet its payment obligations in relation to the Period it cannot be deemed to have taken *reasonable measures*.

Paragraph 7

2559. The application of paragraph 6 is subject to paragraph 7. Paragraph 7(a) requires Parties to apply paragraph 6 only where the Designated Payment Entity or *relief entity*, as relevant, makes an adjustment required as a result of a *comprehensive certainty outcome*, in the first Amount A Tax Return and Common Documentation Package that is filed after the date on which the *comprehensive certainty outcome* is issued.

2560. Where as a result of a *comprehensive certainty outcome*, the Designated Payment Entity needs to make an adjustment in a Party where it does not qualify for streamlined compliance (and therefore must file a return locally) or where a *relief entity* is required to adjust its entitlement to relief from double taxation, paragraph 7(b) requires that Parties are not required to apply paragraph 6 unless the Designated Payment Entity or the *relief entity* make the relevant adjustment in their domestic tax return before the first filing date of the domestic tax return following the date on which the *comprehensive certainty outcome* was issued.

Paragraph 8

2561. Paragraph 8 contains the transitional rule that applies for the initial 3-year period after a Group comes into scope at the level of a *disclosed segment* for the first time (and only the first time). This period is defined separately in paragraph 9(g) which contains the term *mixed segment entity transitional period*.

2562. The transitional rule has been provided as existing financial reporting systems are not always set up to identify a portion of Elimination Profit (or Loss) and Depreciation and Payroll at the level of a *mixed segment entity* that is derived from a particular *disclosed segment* for the purpose of determining the adjustments under Annex C Section 4(7). This is because *disclosed segment* reporting is sometimes performed on a “top-down” basis by allocating consolidated financial information at Group level between different *disclosed segments* reported in the Consolidated Financial Statements. This means it is not necessarily feasible to “trace” Elimination Profit (or Loss) and depreciation and payroll amounts down to an Entity level, which means in the case of a *mixed segment entity* it is not always possible to identify Elimination Profit (or Loss) and Depreciation and Payroll that relate to the business of an in-scope *covered segment* and the Elimination Profit (or Loss) and Depreciation and Payroll that relate to the business of a different *disclosed segment* or *disclosed segments* of the Group.

2563. The transitional rule allows business sufficient time to build and test the necessary systems after which the Elimination Profit (or Loss) and Depreciation and Payroll could be directly traced in the case of

a *mixed segment entity*. After the transitional period is over, the Group would have to directly trace and calculate the relevant portion of Elimination Profit (or Loss) and Depreciation and Payroll for *mixed segment entities* that related to a *covered segment*, as is required under the ordinary rules in Annex C Section 4(7).

Paragraph 9

2564. Paragraph 9 contains the definitions used in Section 1.

2565. The term *initial revenue sourcing transition phase* is defined in subparagraph (a) as the first three Periods for which the Convention is in effect (as defined by the Convention). The term Period refers to the accounting period applicable to the Covered Group, and not the calendar years. This means it is a temporary, time-limited approach covering only the initial years of Amount A, and after the expiry of that period, the transition rules no longer have operative effect. After the *initial revenue sourcing transition phase*, all Covered Groups are expected to apply the revenue sourcing rules and rely on *allocation keys* only in limited circumstances as prescribed in the rules.

2566. Defined in subparagraph (b), a *revenue sourcing transitional period* refers to a Period during the *initial revenue sourcing transition phase* (during which the first element of transition rules, regarding the use of *allocation keys* will also be available for all or any part of a Group's / *disclosed segment's* revenues), and the three consecutive Periods immediately after the *initial revenue sourcing transition phase*, or, where a Group was not a Covered Group or a Group did not have a *disclosed segment* that was a *covered segment* during the *initial revenue sourcing transition phase*, the three consecutive Periods from the beginning date of the Period in which a Group was first a Covered Group or a Group's *disclosed segment* was first a *covered segment*. This essentially requires Parties to allow Covered Groups and *covered segments* who are in scope of Amount A in the first Period after the Multilateral Convention comes into force, six Periods to refine and finalise the development of their systems to comply with the revenue sourcing rules, and three Periods for Covered Groups and *covered segments* who come into scope after the *initial revenue sourcing transition phase*. However, it is intended where a Group or *disclosed segment* has previously been a Covered Group or *covered segment* but has fallen outside of the scope of the Amount A rules, the transition period does not reset.

2567. The term *initial extractives transition phase* is defined in subparagraph (c) as the first six Periods beginning on or after the date on which the Convention enters into effect.

2568. The term *extractives transitional period* is defined in subparagraph (d) as the *initial extractives transition phase*, and the three consecutive Periods that immediately follow, or for Groups which did not meet the requirements of Article 3(1) and (2), as modified by Annex C, during the *initial extractives transition phase*, the three consecutive Periods from when the Group was first a *qualifying extractives group* which met the requirements of Article 3(1) and (2), as modified by Annex C.

2569. The term *regulated financial services transitional period* is defined in subparagraph (e) as the first three consecutive Periods from when the Group or *disclosed segment* first met the requirements of Article 3(1) and (2), as modified by Annex C. The purpose of this transition rules is to provide for a limited period of learning and refinement in the context of the *advance certainty review* process.

2570. Groups or *disclosed segments* will only be eligible for the transition under paragraphs 1, 3, 4, and 6 where *reasonable measures* have been taken. *Reasonable measures* is defined as efforts that are consistent with the guidance provided by the *scope review panel*, *review panel*, *determination panel*, or by the Conference of the Parties. In taking *reasonable measures*, the steps taken by the Group or *disclosed segment* to implement guidance issued to it by a *review panel*, *scope review panel*, or *determination panel* will be relevant. Where a Group or *disclosed segment* submits a request for a *comprehensive certainty*

review or a *scope certainty review* for a Period (during a *revenue sourcing transitional period*, an *extractives transitional period*, or a *regulated financial services transitional period*, as relevant) that commenced before such guidance (i.e. the guidance provided by the relevant Panel) was given, the Group or *disclosed segment* may apply the same approach as was accepted previously and that approach shall be accepted. Where a Group or *disclosed segment* submits a request for a *comprehensive certainty review* or a *scope certainty review* for a relevant Period that commenced after such guidance was given, steps taken by the Group or *disclosed segment* to implement this guidance will be considered in determining whether the Group or *disclosed segment* has taken *reasonable measures*. This consideration will also take into account the time elapsed since such guidance was given. Examples of what constitutes *reasonable measures* under various scenarios will be agreed as part of the future guidance on the implementation of Amount A.

Section 2 - Simplified scope calculations

2571. Paragraph 1 provides that a Party shall permit a Group to demonstrate that it does not meet the requirements of Article 3(1)(a), as modified by Annex C, using one of four simplified methods. This is relevant for a Group that is a *qualifying extractives group* (as defined in Annex C Section 3), that can demonstrate that after the exclusion of *extractives revenue*, the Group does not meet the EUR 20 billion revenue threshold, and is therefore not in scope of the Convention.

2572. The four simplified methods are as follows.

2573. In subparagraph (a), deducting from the Adjusted Revenues of the Group the revenues included in the Consolidated Financial Statements that are reported in one or more *extractives segments* to the extent that the result of this calculation demonstrates that the Group does not meet the requirements of Article 3(1)(a) (as modified by Annex C). *Extractives segment* is defined in Annex C Section 3. This method provides that a *qualifying extractives group* could deduct the third party revenues reported in one or more *extractives segments* from the Adjusted Revenues, and if the result is EUR 20 billion or less, the group will not meet the requirements of Article 3(1)(a) (as modified by Annex C). If the Group had more than one *extractives segment*, the Group would not need to use the simplified method for all *extractives segments*, but only with respect to as many *extractives segments* as necessary to demonstrate it does not meet the requirements of Article 3(1)(a) (as modified by Annex C).

2574. In subparagraph (b), deducting the revenues included in the Consolidated Financial Statements that are reported in one or more *extractives entities*, to the extent that the result of this calculation demonstrates that the Group does not meet the requirements of Article 3(1)(a) (as modified by Annex C). This is the same approach as in subparagraph (a), but deducting by reference to *extractives entities* rather than an *extractives segment*. *Extractives entity* is defined in Annex C Section 3. This method provides that a *qualifying extractives group* could deduct the third party revenues reported by one or more *extractives entities* from the Adjusted Revenues, and if the result is EUR 20 billion or less, the Group will not meet the requirements of Article 3(1)(a) (as modified by Annex C). If the Group had more than one *extractives entity*, the Group would not need to use the simplified method for all *extractives entities*, but only with respect to as many *extractives entities* as necessary to demonstrate it does not meet the requirements of Article 3(1)(a) (as modified by Annex C).

2575. In subparagraph (c), aggregating the revenues of all *non-extractives segments* and all *mixed segments* reported in the Group's financial statements, to the extent the result of this calculation demonstrates that the Group does not meet the requirements of Article 3(1)(a) (as modified by Annex C). *Non-extractives segment* and *mixed segment* are defined in Annex C Section 3. This method provides that a *qualifying extractives group* could add the total revenues (i.e. both third party and intra-group revenues)

reported in all *non-extractives segments* and all *mixed segments*, and if the result is EUR 20 billion or less, the Group will not meet the requirements of Article 3(1)(a) (as modified by Annex C). By not requiring the exclusion of intra-group revenues, and not requiring the removal of *extractives revenues* from these segments, it simplifies the approach, and means the Group will over-include revenue for this test. In other words, it is a more conservative approach, and if the Group can still demonstrate the result is that such revenues are EUR 20 billion or less, the Group would not meet the requirements of Article 3(1)(a) (as modified by Annex C).

2576. In subparagraph (d), aggregating the revenues of all entities that are not *extractives entities* (i.e. *non-extractives entities* and *mixed entities*) reported in the Entities' financial statements, to the extent the result of this calculation demonstrates that the Group does not meet the requirements of Article 3(1)(a) (as modified by Annex C). *Extractives entity*, *non-extractives entity* and *mixed entity* are defined in Annex C Section 3. This method provides that a *qualifying extractives group* could add the total revenues (i.e. both third party and intra-group revenues) reported by all Entities that are *non-extractives entities* and all Entities that are *mixed entities*, and if the result is EUR 20 billion or less, the Group will not meet the requirements of Article 3(1)(a) (as modified by Annex C). By not requiring the exclusion of intra-group revenues, and not requiring the removal of *extractives revenues* from these Entities, it simplifies the approach, and means the Group will over-include revenue for this test. In other words, it is a more conservative approach, and if the Group can still demonstrate the result is that such revenues are EUR 20 billion or less, the Group would not meet the requirements of Article 3(1)(a) (as modified by Annex C). Subparagraph (d) also provides for a pro-rata adjustment in cases where the entity's financial statement period does not align with the Group's Period.

2577. Paragraph 2 confirms that where one of the simplified methods applies, the Group is not otherwise required to apply the detailed calculations for arriving at *non-extractives adjusted revenues* that is set out in Annex C Section 3.

2578. Paragraph 3 provides that a Party shall permit a Group to demonstrate that it does not meet the requirements of Article 3(1)(a) (as modified by Annex C) using one of two simplified methods. This is relevant for a Group that includes one or more *regulated financial institutions* (as defined in Annex C Section 2), that can demonstrate that after the exclusion of the revenue from *regulated financial institutions*, the Group does not meet the EUR 20 billion revenue threshold, and is therefore not in scope of the Convention.

2579. The two simplified methods are as follows.

2580. In subparagraph (a), deducting the revenues included in the Consolidated Financial Statements that are derived by one or more *regulated financial institutions*, to the extent that the result of this calculation demonstrates that the Group does not meet the requirements of Article 3(1)(a) (as modified by Annex C). This method provides that a Group could deduct the third party revenues reported in one or more *regulated financial institutions* from the Adjusted Revenues, and if the result is EUR 20 billion or less, the Group will not meet the requirements of Article 3(1)(a) (as modified by Annex C). If the Group had more than one *regulated financial institution*, the Group would not need to use the simplified method for all such Entities, but only with respect to as many *regulated financial institutions* as necessary to demonstrate it does not meet the requirements of Article 3(1)(a) (as modified by Annex C). This method does not require a Group to exclude *related investment revenue* derived by Group Entities that are not *regulated financial institutions*.

2581. In subparagraph (b), aggregating the revenues of all Entities that are not *regulated financial institutions* reported in the Entities' financial statements, to the extent the result of this calculation demonstrates that the Group does not meet the requirements of Article 3(1)(a) (as modified by Annex C). This method provides that a Group could add the total revenues (i.e. both third party and intra-group

revenues without excluding *related investment revenue*) reported by all Entities that are not *regulated financial institutions*, and if the result is EUR 20 billion or less, the Group will not meet the requirements of Article 3(1)(a) (as modified by Annex C). By not requiring the exclusion of intra-group revenues and *related investment revenue*, it simplifies the approach, and means the Group will over-include revenue for this test. In other words, it is a more conservative approach, and if the Group can still demonstrate the result is that such revenues are EUR 20 billion or less, the Group would not meet the requirements of Article 3(1)(a) (as modified by Annex C). Subparagraph (b) also provides for a pro-rata adjustment in cases where the Entity's financial statement period does not align with the Group's Period.

2582. Paragraph 4 confirms that where one of the simplified methods applies, the Group is not otherwise required to apply the detailed calculations for arriving at *non-RFS adjusted revenues* that is set out in Annex C Section 2.

Annex F – Supplementary provisions for Section 2 of Part V

Section 1 – Certainty reviews

Paragraph 1

2583. Under paragraph 1, typically, a *scope certainty review* or *comprehensive certainty review* shall not commence until any similar review that has been requested for an earlier Period is ended. However, the Conference of the Parties may agree a process for the reviews for two or more years to be undertaken simultaneously.

Paragraph 2

2584. To ensure reviews are as coordinated and efficient as possible, where a review is undertaken by a *scope review panel* or *review panel*, all engagement between a panel and a Group, including any requests for additional information or explanation, shall be undertaken by the *lead tax administration* through the *coordinating entity*.

2585. It is important that reviews are undertaken efficiently, and this can be facilitated through the use of strict timeframes. Where additional information or clarification is required, this should be required from the *coordinating entity* within 30 days and it is expected that in the majority of cases a *coordinating entity* should be able to comply with this deadline. Where more time is needed, this may be agreed by the *lead tax administration*, but any extension should be for the minimum time that is needed. The *lead tax administration* should ensure that members of the *scope review panel* or *review panel* are aware of and understand the reasons for any delay.

2586. The use of templates where appropriate should also facilitate reviews by ensuring consistency in approach between cases. As such, the Conference of the Parties shall agree a standard template to be used where explanation is sought from a *coordinating entity* as to its approach to a particular aspect of the Convention. This shall also ensure that information is presented in a standard format in cases where a particular issue is referred to a *determination panel* and the *coordinating entity's* explanation is provided to *determination panel* members under Article 27.

Paragraph 3

2587. The structure of a review is flexible, in order to allow a *scope review panel*, *review panel* or *lead tax administration* to determine its own way of working, so long as it undertakes an effective review on behalf of *listed parties* or *affected parties*. This shall include calls and virtual or physical meetings between members of a panel and may also include one or more calls or such meetings with the *coordinating entity*, in accordance with Article 37. The number and frequency of these calls or meetings shall be agreed by the *lead tax administration* and members of a *scope review panel* or *review panel*, depending upon the needs and circumstances of a particular review.

2588. The *lead tax administration* may also provide a *coordinating entity* with updates as to the progress of a review. The timing and format of these updates may be agreed by the *lead tax administration*, *scope review panel* or *review panel* and *coordinating entity*. These updates shall not include any information as to the position of any *listed party* or *affected party*, including members of a panel, without the agreement of that Party. However, where members of *scope review panel*, *review panel* or the *lead tax administration* do not agree with respect to an aspect of the *coordinating entity's* approach or intend to propose a change

to that approach, the *coordinating entity* shall be given an opportunity to provide an explanation as to its approach.

Paragraph 4

2589. In order for a review to be effective and reduce the risk of disagreements being taken to a *determination panel* which could have been resolved more easily at an earlier stage, any *listed party* or *affected party* not on a *scope review panel* or *review panel* may submit any concerns they have with respect to a Group's application of the Convention. These concerns should be taken into account by the *scope review panel*, *review panel* or *lead tax administration*, which should seek to address them as part of its review. This may include identifying changes which should be made to a Group's application of the Convention, or obtaining additional information or explanation to resolve the concern without the need for changes to be made.

Paragraph 5

2590. Wherever possible, members of a *scope review panel* or *review panel* shall seek to reach agreement with respect to each aspect of a *coordinating entity's* application of the Convention in the documentation package filed with its request for certainty, whether that means to accept the approach in the relevant documentation package or to require agreed changes to be made.

2591. However, it is also important that timeframes in the Convention are respected and so, once it becomes clear that agreement will not be reached on a particular aspect of an approach in the documentation package, a panel should cease discussions on that aspect. The panel shall continue to seek to reach agreement on other aspects, even if this means that it needs to focus on the approach taken by *coordinating entity* in the documentation package rather than on agreeing numeric elements.

Paragraphs 6 and 7

2592. Paragraphs 6 and 7 concern situations where, in the course of a *comprehensive certainty review*, the *review panel* or *lead tax administration* determines that there is an *affected party* for the Period that was not previously identified. This may occur, for example, where the *review panel* or *lead tax administration* propose changes to a Group's application of the *revenue sourcing* rules in Articles 6 and 7.

2593. Under paragraph 6, in such a situation the Competent Authority of the Party of the *lead tax administration* shall inform the Competent Authority of the relevant Party within 30 days and exchange the Group's Amount A Tax Return and Common Documentation Package, as well as any other information that has been exchanged with other *affected parties*.

2594. Where a request for *advance certainty* was submitted at the same time as the request for *comprehensive certainty*, as well as the exchange in paragraph 6, under paragraph 7 the Competent Authority of the Party of the *lead tax administration* shall exchange the *advance certainty documentation package*, and any other information that has been exchanged with other *affected parties* for purposes of the *advance certainty review*.

Paragraph 8

2595. Where provisions of the Convention specifically require the use of data from a Group's Consolidated Financial Statements, and these financial statements have been subject to independent audit, no change shall be required to that data. For example, where Article 2(d) refers to the revenues that are reported in the Consolidated Financial Statements of a Group for a Period, where these financial

statements have been subject to independent audit, these revenues should not be challenged. Where a Group's Consolidated Financial Statements are not audited, where the Convention does not require the use of data from a Group's Consolidated Financial Statements, or where the Convention requires adjustments to be made to data taken from a Group's Consolidated Financial Statements, changes may be required to these aspects of a Group's approach, if they are not consistent with provisions of the Convention. A review shall also consider, and may require changes to, how data is used for the purpose of applying the Convention, including computational elements.

Paragraph 9

2596. A *scope certainty review* or *comprehensive certainty review* shall not consider the pricing of transactions between related parties, other than to the extent that a transaction is deemed to give rise to Adjusted Revenues under provisions of the Convention. Otherwise, a *scope review panel*, *review panel* or *lead tax administration* shall consider whether an adjustment required under the domestic law of a Jurisdiction or under a process contained in an international agreement has been correctly reflected for the purpose of applying the Convention. Paragraph 9 does not apply where a transaction is deemed to occur by provisions of the Convention and for no other purpose, and the relevant provision requires that deemed transaction be priced at arm's length. The outcome of a review with respect to the pricing of such a transaction shall have no effect for any purpose other than for a *scope certainty outcome* or *comprehensive certainty outcome* under Article 29.

Paragraph 10

2597. A *scope review panel*, *review panel* or *lead tax administration* shall not require or consider details of individual transactions for the purpose of determining whether the Group is a *defence group* or whether any particular revenues are *defence revenues* (as defined in Annex C Section 6). For example, this would include information on specific contracts that give rise to *defence revenues*, as well as customer information and information related to the pricing of transactions that give rise to *defence revenues*.

2598. Paragraph 10 further provides guidance on the nature of inquiries that can be made with respect to the defence adjustment. This is limited to general inquiries, such as how a Group has identified the relevant revenues, how such revenues reconcile to public information contained in the Consolidated Financial Statements, and identifying the relevant national law that indicates that revenues are *defence revenues* (i.e. the relevant export control regulations or laws prohibiting the disclosure information for national security purposes). This would be particularly relevant for a Group that is also engaged in commercial activities, such as supplying commercial aircraft, and if requested, such a Group could be requested to describe the process used for identifying the revenues that are *defence revenues* and those that are not.

2599. As such, the approach to be taken by a *scope review panel*, *review panel* or *lead tax administration* can not be to request or evaluate details of any individual transaction, but rather to make enquiries at a higher, conceptual or structural level. This allows the *scope review panel*, *review panel* or *lead tax administration* to perform a high level review of whether the defence adjustment has been applied appropriately, while respecting the sensitivities related to defence transactions.

2600. In addition, the language in paragraph 10 covers the tax certainty process with respect to some revenues that are not themselves *defence revenues*. These are revenues related to the sales of supplies (including components of such supplies) described under Annex C Section 6(3)(b)(i)(B) (i.e. the export control regulations) or Annex C Section 6(3)(b)(ii) (i.e. supplies in respect of which information is prohibited by law designed to protect defence or intelligence services). This would cover revenues, for example, that were derived from a supply which was a component part of a finished good, where the component is not

itself subject to export control or disclosure laws, but the resulting finished good would be. The focus of this language is on the types of products (or components thereof) that are subject to export control regulation or information disclosure prohibition, without requiring that the supply is sold to or used by a *specified government body* in a given case. In other words, the limitation on granular inquiries related to commercial details of these supplies is wider than the substantive definition of *defence revenues*, recognising that these supply chains can also contain sensitive information that could be used to understand sensitive details about a supply that has a *defence purpose*.

2601. These provisions are without prejudice to further guidance as to how the certainty process shall operate more generally with respect to defence and non-defence matters. The language in paragraph 10 recognises and defers to the specific nature of defence, where the disclosure of information is particularly sensitive in the context of defence and intelligence services, and may be prohibited by domestic laws.

Paragraph 11

2602. A *scope review panel, review panel or lead tax administration* shall wherever appropriate take into account any *certainty outcomes* agreed for the Group for earlier Periods. Where a *coordinating entity* has previously requested certainty and a *certainty outcome* has been agreed, the *coordinating entity* will reasonably expect the Convention to be applied consistently in future Periods, unless a relevant aspect of the Group's business or activities has changed which requires a different conclusion. To facilitate this, the *lead tax administration* should make available to members of a *scope review panel or review panel* information pertaining to a previous review that is relevant to the current review, subject to Article 37.

2603. Where for any reason the recommendation of a *scope review panel, review panel or lead tax administration* is not consistent with an aspect of a previous *certainty outcome*, an explanation of this shall be included in the summary of outcomes of the review that is exchanged with *listed parties or affected parties*. This ensures that the *listed parties or affected parties* are aware that a different approach is being recommended compared to a previous review, and the reasons for this, and allows them the opportunity to agree or disagree with the change.

Paragraph 12

2604. The Conference of the Parties shall agree the content of the Amount A Tax Return and Common Documentation Package, as well as documentation to be provided with a request for certainty. These documentation requirements shall include confirmation and supporting evidence, in a form to be agreed, that any approaches contained in an agreed *advance certainty outcome* that applies for a Period have been implemented and correctly applied, and that agreed *critical assumptions* continue to apply. Under paragraph 12, this confirmation and evidence shall be considered as part of a *scope certainty review or comprehensive certainty review* by a *scope review panel, review panel or lead tax administration*.

2605. Where a *listed party or affected party* (including a member of a *scope review panel, review panel or the lead tax administration*) provides information that indicates that an agreed approach contained in an *advance certainty outcome* has not been implemented, has not been correctly applied or that agreed *critical assumptions* no longer apply, this shall also be included in a review.

2606. Other than in the above circumstances, a *scope certainty review or comprehensive certainty review* shall not consider the agreed approaches contained in an *advance certainty outcome* that applies for the Period.

Paragraph 13

2607. Paragraph 13 provides that where in the view of a *scope review panel*, *review panel* or *lead tax administration*, the approach contained in an agreed *advance certainty outcome* has not been implemented, has not been correctly applied or one or more agreed *critical assumptions* are no longer met, the *scope certainty review* shall be undertaken on the basis that the affected elements of the *advance certainty outcome* do not apply. This does not mean that the approach taken by the *coordinating entity* is incorrect or that changes are required to a Group's Amount A Tax Return and Common Documentation Package. However, as aspects of the *advance certainty outcome* no longer apply, this shall need to be confirmed as part of a review.

2608. Elements of the *advance certainty outcome* that are not affected by paragraph 13 continue to apply. For example, where a Group has several different categories of Adjusted Revenues, and its revenue sourcing approach for each of these categories is covered by an *advance certainty outcome*, a failure by the Group to implement the agreed approach to one category of Adjusted Revenues does not prevent the *advance certainty outcome* continuing to apply to other categories, if the agreed approach to those categories of Adjusted Revenues was implemented and applied correctly.

Paragraph 14

2609. Paragraph 14 describes a number of circumstances in which a *review panel* or *lead tax administration* may propose that one or more categories of Adjusted Revenues be sourced using a different *reliable method* to that used by a Group for a Period. However, before doing so they should seek confirmation from the *coordinating entity* that the Group has the information necessary to apply that *reliable method*. Where the Group does not have this information, the *review panel* or *lead tax administration* may recommend that the approach taken by the *coordinating entity* be accepted for the Period under review, or that an alternative approach be applied for that Period, such as the use of a relevant *allocation key* applicable to the particular category or categories of Adjusted Revenues. The summary of outcomes of the review should include an explanation of this.

2610. Where it is decided either by *affected parties* or by a *determination panel* that a *coordinating entity* should have used a different *reliable method* for a Period but, reflecting a recommendation under paragraph 14, the *reliable method* used by the *coordinating entity* or an alternative approach such as a relevant *allocation key* is accepted, the *comprehensive certainty outcome* shall include an explanation of this and the approach it is agreed should have been used. This ensures that where in future a *review panel* or *lead tax administration* takes into account the outcomes of previous reviews, they are fully aware where the approach accepted for an earlier Period was done so as a concession and was not the approach that it was agreed should have been used.

Paragraph 15

2611. In general, where a *coordinating entity's* approach to applying a provision of the Convention is accepted for one Period, the Group has a reasonable expectation that the same approach shall be accepted in another Period unless there has been a change to the Group's business or activities which requires a different approach to be adopted. Paragraph 15 therefore describes a general principle that where a *coordinating entity* submits a request for *scope certainty* together with a request for *scope advance certainty*, the outcomes of the subsequent reviews with respect to the same provisions of the Convention or the same elements of a Group's *internal control framework* should be consistent.

2612. This does not mean that the outcomes of reviews requested at the same time need to be the same if there is a specific reason for reaching a different conclusion. For example, where a Group has recently

undertaken an internal restructuring, or has introduced improvements to its *internal control framework*, the outcomes of a *scope certainty review* and a *scope advance certainty review* requested together may differ with respect to the Group's methodology for determining its *non-extractives adjusted profit before Tax* or the reliability of relevant aspects of its *internal control framework*. If this is to reflect a change that has occurred, then this difference would not be inconsistent. However, the reason for any difference should be explained in the summary of outcomes of the two reviews.

Paragraph 16

2613. As mentioned before, in general, where a *coordinating entity's* approach to applying a provision of the Convention is accepted for one Period, the Group has a reasonable expectation that the same approach shall be accepted in another Period unless there has been a change to the Group's business or activities which requires a different approach to be adopted. Paragraph 16 therefore describes a general principle that where a *coordinating entity* submits a request for *comprehensive certainty* together with a request for *advance certainty*, the outcomes of the subsequent reviews with respect to the same provisions of the Convention or the same elements of a Group's *internal control framework* should be consistent.

2614. This does not mean that the outcomes of reviews requested at the same time need to be the same if there is a specific reason for reaching a different conclusion. For example, where a Group has recently undertaken a restructuring of its distribution function, or has introduced improvements to its *internal control framework*, the outcomes of a *comprehensive certainty review* and an *advance certainty review* requested together may differ with respect to the Group's *reliable method* for sourcing its Adjusted Revenues to Jurisdictions or the reliability of relevant aspects of its *internal control framework*. If this is to reflect a change that has occurred, then this difference would not be inconsistent. However, the reason for any difference should be explained in the summary of outcomes of the two reviews.

Paragraphs 17 and 18

2615. A *follow-up scope certainty review* may be requested by a Group which has previously been found not to be a Covered Group, and that meets criteria in Article 22(7), to be reviewed to determine whether it continues not to be a Covered Group based on a *follow-up scope certainty documentation package*, including simplified documentation requirements. However, where a *scope review panel* or *lead tax administration* anticipates that it will not be able to recommend to *listed parties* that the Group continues not to be a Covered Group on the basis of this simplified documentation, the *lead tax administration* shall explain this to the *coordinating entity*.

2616. The *coordinating entity* may decide to allow the *follow-up scope certainty review* to continue. Alternatively, if it still considers the Group not to be a Covered Group, it may withdraw its request for *follow-up scope certainty* and file a request for *scope certainty* accompanied by a *scope certainty documentation package* within 90 days. On the other hand, if in light of the comments of the *lead tax administration*, the *coordinating entity* now considers the Group to be a Covered Group for the Period, it should file an Amount A Tax Return and Common Documentation Package with the *lead tax administration* by the later of the applicable filing deadline and 180 days after withdrawing its request for *follow-up scope certainty*.

Paragraph 19

2617. It is an important element of the certainty processes included in the Convention that where a *coordinating entity* submits a request for certainty, it shall act in a transparent and cooperative manner, including by providing accurate and complete information in response to requests by the applicable deadline, or an adequate explanation as to why more time is needed.

2618. Where in the view of a *scope review panel*, *review panel* or *lead tax administration*, a *coordinating entity* does not comply with this expectation, paragraph 19 provides a process whereby the issue shall be raised with the *coordinating entity* and, if it is not addressed, the *coordinating entity* may be considered to have withdrawn its request for certainty and a review shall conclude without an agreed *certainty outcome*. A *coordinating entity* shall not be considered to have acted in an uncooperative or non-transparent manner where requested information or clarification is provided after a deadline agreed by the Conference of the Parties, if the *coordinating entity* informed the *lead tax administration* of the reason for the delay before that deadline and the requested information or clarification is provided within the period agreed with the *lead tax administration*.

2619. Where a review was undertaken by a *scope review panel* or *review panel*, and the review concludes in accordance with paragraph 19 without an agreed *certainty outcome*, the *coordinating entity* shall not be able to submit a further request for certainty under the same Article with respect to the same Period. Where a review was undertaken by a *lead tax administration*, the next time the group submits a request for *scope certainty* or *comprehensive certainty*, the review shall be undertaken by a *scope review panel* or *review panel* as appropriate. At that point, the *coordinating entity* may request that the *scope review panel* or *review panel* also undertakes a review for the Period for which a *certainty outcome* was not provided. This ensures that a Group is not permanently denied *scope certainty* or *comprehensive certainty* for any Period following a decision by a single Party.

2620. A *coordinating entity* is not precluded from submitting requests for certainty with respect to subsequent Periods in future, but shall be expected to provide written confirmation that these issues have been addressed and shall not recur.

Paragraph 20

2621. Where a *comprehensive certainty review* is undertaken by a *review panel*, the outcomes of a review shall not propose any change which is not agreed by all members of the *review panel*, unless it meets at least one of the conditions in paragraph 20.

2622. These conditions require a change proposed by a member of the *review panel* that is not agreed by the panel as a whole to have at least a minimum impact on one or more of a number of specific items in a Group's Amount A Tax Return and Common Documentation Package. Where a member of a *review panel* does not agree that an approach taken by the *coordinating entity* is a correct application of the Convention but in the course of the review it has been unable to determine the specific financial impact of a change to this approach (e.g. where the *review panel* member does not agree that the *reliable indicator* used by the *coordinating entity* is a *reliable indicator*, but it does not have access to information on the impact of using a different *reliable indicator*) the outcomes of the review may include a proposal by that member that a different approach be applied. However, the *review panel* member should withdraw its proposal for a change if the *coordinating entity* has provided information that demonstrates that the actual impact of the proposed change is below the relevant threshold and this is accepted by that member. If the *review panel* member does not accept that the impact of the proposed change is below the threshold, it is not required to withdraw its proposal but should include an explanation as to why this is the case.

2623. Paragraph 20 only concerns changes that are proposed in the outcomes of a *comprehensive certainty review*, and which shall be resolved by a *determination panel* under the process in Article 27. This paragraph does not in any way limit the ability of a member of a *review panel* to raise concerns for discussion within the *review panel*, and to seek agreement by other members of the *review panel* that a particular change should be required.

Paragraph 21

2624. Paragraph 21 includes a deadline for a review by a *scope review panel*, *review panel* or *lead tax administration*. These timelines run from the date on which a review commences, not from the date when a request for certainty is submitted.

2625. The deadlines in subparagraph (a) through (c) may be extended to reflect a delay that has been caused by the *coordinating entity*. This may be because the *coordinating entity* was late in providing information, including where a time extension was agreed under paragraph 2, or because it acted in an uncooperative or non-transparent manner, including by providing inaccurate or incomplete information. The extension of the deadline shall equal the delay caused by the *coordinating entity*.

2626. The first time a *coordinating entity* submits a request for certainty under a particular paragraph of Article 22 or 23, the deadlines in paragraph 21 are increased by 90 days. This reflects the fact that the first time a particular aspect of a Group's application of the Convention is reviewed, more time may be needed to consider whether the Group's approach is in accordance with the Convention.

Paragraph 22

2627. Notwithstanding the deadlines for a *scope certainty review* and *comprehensive certainty review* in paragraph 20, where it is determined in the course of such a review that one or more *critical assumptions* applicable to an *advance certainty process* no longer apply, it shall be necessary for a *scope review panel*, *review panel* or *lead tax administration* to undertake additional work to determine whether this has any implications for the appropriateness of the approach set out in the *advance certainty outcome*. The fact that a *critical assumption* no longer applies does not mean that the approach taken by the *coordinating entity* in the *scope certainty documentation package* or Amount A Tax Return and Common Documentation Package is not correct, but this should be confirmed. As such, in these circumstances the time permitted for a review is increased by 90 days.

Paragraph 23

2628. Paragraph 23 concerns situations where a member of a *scope review panel* or *review panel*, or the *lead tax administration*, has not reached a decision with respect to a particular aspect of a Group's approach by the end of the timeframe permitted for a review under paragraph 21.

2629. Where a member of a *scope review panel* or *review panel*, or the *lead tax administration* has not reached a decision by the deadline in paragraph 21, this deadline shall be extended by a further 30 days in order for a decision to be reached.

2630. Where a review is undertaken by a *scope review panel* or *review panel*, and any member of the panel has been unable to reach a decision as to whether an aspect of the approach taken by a Group is correct, or as to what alternative approach should have been taken, but where all other members of the *scope review panel* or *review panel* reach agreement, then the member of the panel that has been unable to reach a decision shall not prevent the panel being treated as if it has reached agreement. Other members of the panel shall be able to agree that the Group's approach to this aspect is correct, or changes that should be required to this approach.

2631. Where a review is undertaken by the *lead tax administration*, and the *lead tax administration* has been unable to reach a decision as to whether an aspect of the approach taken by a Group is correct, or as to what alternative approach should have been taken, the *lead tax administration* shall be deemed to support the approach to that aspect taken by the Group.

Paragraph 24

2632. It is a fundamental feature of the *tax certainty framework* in this Section that, while a review is undertaken by a *scope review panel*, *review panel* or *lead tax administration*, *certainty outcomes* are agreed by all *listed parties* or *affected parties* and these should have the opportunity to consider the outcomes of a review and raise disagreements in accordance with this Annex. Where disagreements are raised by *listed parties* or *affected parties* which cannot be resolved through consultation, these shall be referred to a *determination panel* for resolution under Article 27, guaranteeing a *certainty outcome* for a Group that requests certainty within the timeframes in the Convention.

Paragraphs 25 through 28

2633. Within 30 days of the end of a review, the Competent Authority of the Party of the *lead tax administration* shall exchange a summary of the outcomes of the review with the Competent Authorities of all *listed parties* or *affected parties*. This shall include a recommendation that the approach taken by a *coordinating entity* in the documentation package filed with its request for certainty is agreed as filed, a recommendation that specified changes should be required to this approach or, where a review was undertaken by a *scope review panel* or *review panel*, a statement that the panel was unable to reach agreement including all members.

2634. The summary of outcomes circulated to *listed parties* or *affected parties* following the end of a *scope advance certainty review* or *advance certainty review* shall also include the outcomes of the panel's review of aspects of the Group's *internal control framework* relevant to the proposed approaches in the *advance certainty documentation package* filed by the *coordinating entity*. This summary shall include a recommendation that these aspects of the *internal control framework* are designed and operating effectively, a recommendation that one or more specified improvements to these aspects of the *internal control framework* be required, or a statement that the panel was unable to reach agreement including all members.

2635. Where a review was undertaken by a *scope review panel* or *review panel*, and the panel was unable to reach agreement on one or more aspects of a *coordinating entity's* approach, the summary of outcomes shall also include a description of these aspects, the different positions of the members of the panel, and any changes to this approach proposed by members of the panel.

Paragraph 29

2636. In the event that the *lead tax administration* or one or more members of a *scope review panel* or *review panel* was unable to reach a decision with respect to any aspect of the approach set out in a *coordinating entity's* documentation package by the deadline in paragraph 21, the summary of outcomes shall include an explanation of this and the reasons given by the *lead tax administration* or member of the panel as to why it was unable to reach a decision.

Paragraphs 30 and 31

2637. Following the exchange of the summary of outcomes in paragraphs 25 through 28, the Competent Authorities of *listed parties* and *affected parties* have 90 days to submit written comments.

2638. Comments submitted to the Competent Authority of the Party of the *lead tax administration* should be as specific as possible. Where a Competent Authority disagrees with a recommendation in a statement of outcomes it should identify the specific items in the relevant documentation package or changes

recommended by the *scope review panel*, *review panel* or *lead tax administration* that it does not agree with and provide a paper explaining its position.

2639. Where a *comprehensive certainty review* has been undertaken, any comments disagreeing with a recommendation in the statement of outcomes should also include the financial impact on the Jurisdiction of the Competent Authority or, where this is not possible, a description of the possible financial impact in that Jurisdiction, and the change to a numeric item or other outcome proposed to address this issue.

2640. Where a *scope advance certainty review* or *advance certainty review* has been undertaken, comments disagreeing with a recommendation in a statement of outcomes should explain why a proposed approach as filed or reflecting changes recommended by the *scope review panel* or *review panel* does not reflect a correct application of the Convention, the alternative approach proposed by the Competent Authority and why in its view this reflects a more correct application of the Convention.

Paragraph 32

2641. Where a summary of the outcomes of a *comprehensive certainty review* is submitted to *affected parties* for comments, no *affected party* shall submit comments that propose a change to the approach included in a Group's Amount A Tax Return and Common Documentation Package or in a recommendation by a *review panel* or *lead tax administration*, that do not meet the conditions in paragraph 32.

2642. Under subparagraph (a), an *affected party* shall not propose a change if it is not either able to identify a financial impact in its Jurisdiction, or to describe a possible financial impact in its Jurisdiction. There may be cases where an *affected party* does not agree that the approach taken by a *coordinating entity* reflects a correct application of the Convention, but does not have sufficient information to enable it to identify the specific financial impact on its Jurisdiction of a change to the approach that it considers to be correct. For example, an *affected party* may consider that the method used by the Group for its revenue sourcing is not a *reliable method*, but is unlikely to have information on the revenues that would be sourced from its Jurisdiction if a different *reliable method* was used. In this case, it would be sufficient for the *affected party* to describe the possible financial impact in its Jurisdiction.

2643. Under subparagraph (b), an *affected party* shall not propose a change which does not have at least a minimum impact on one or more of a number of specific items in a Group's Amount A Tax Return and Common Documentation Package relevant to its Jurisdiction. Where an *affected party* does not agree that an approach taken by the *coordinating entity* is a correct application of the Convention but based on the information available it is unable to identify the specific financial impact of a change to this approach on its Jurisdiction, it may nevertheless submit comments proposing a change to this approach. If the *coordinating entity* provides additional information that demonstrates that the actual impact of the proposed change in the *affected party's* Jurisdiction is below the threshold in subparagraph (b) and this is accepted by the *affected party*, the *affected party* should withdraw its comments. If the *affected party* does not accept that the impact of the proposed change in its Jurisdiction is below the threshold in subparagraph (b), it may inform the Competent Authority of the Party of the *lead tax administration* that, notwithstanding the information provided by the *coordinating entity*, it does not withdraw its comments together with an explanation as to why this is the case.

2644. Under subparagraph (c), an *affected party* shall only propose a change that is inconsistent with a previous *comprehensive certainty outcome* for a Period in which it was an *affected party* if it also provides an explanation as to why such a change is necessary for a correct application of the Convention.

2645. Under subparagraph (d), an *affected party* shall only propose a change that is inconsistent with an *advance certainty outcome* with respect to which it was an *affected party* if it also provides evidence that one or more agreed *critical assumptions* pertaining to that outcome are no longer met.

2646. Under subparagraph (e), an *affected party* shall not propose any other change that could not be proposed by the *scope review panel*, *review panel* or *lead tax administration* conducting a review under Article 26, taking into account the provisions of this Annex.

Paragraph 33

2647. If following a *scope certainty review*, *follow-up scope certainty review*, *scope advance certainty review* or *advance certainty review*, the Competent Authority of a *listed party* or *affected party* submits written comments that are inconsistent with any *certainty outcome* agreed for a Period in which it was a *listed party* or *affected party*, an explanation should be provided as to why comments are necessary for a correct application of the Convention.

Paragraph 34

2648. Where the Competent Authority of a *listed party* or *affected party* does not submit written comments by the deadline in paragraph 30 or 31 it shall be considered for purposes of the Convention to agree to the recommendation of the *scope review panel*, *review panel* or *lead tax administration*. This does not prevent the Competent Authority subsequently submitting comments in support of an objection raised by the Competent Authority of another *listed party* or *affected party* under Article 27.

Paragraph 35

2649. Paragraph 35 sets out an approach to resolve disagreements raised by Competent Authorities of *listed parties* or *affected parties* in their written comments. Beginning with the deadline for written comments in paragraph 30 or 31, the *scope review panel*, *review panel* or *lead tax administration* has 60 days to consider whether to adopt the Competent Authority's proposal for a change to the approach contained in its recommendation.

2650. If the *coordinating entity* has not previously provided a written explanation of the Group's approach to the relevant issue, it shall be requested to provide such explanation within 30 days following the start of this period. A *coordinating entity's* explanation of the approach taken by the Group to applying an aspect of the Convention shall be prepared using a standard template. The *scope review panel*, *review panel* or *lead tax administration* should only determine to adopt the Competent Authority's proposal if in the view of the panel or *lead tax administration* this reflects a more correct application of the Convention. Even where this is the case, if the *scope review panel*, *review panel* or *lead tax administration* considers it likely that other *listed parties* or *affected parties* will not agree the Competent Authority's proposal, it should consider allowing the disagreement to progress directly to a *determination panel* for resolution under Article 27.

2651. Where a Competent Authority submits a written comment under paragraph 32 proposing a change with respect to which it cannot quantify the financial impact in its Jurisdiction, the *review panel* may by *consensus* agree to adopt that proposal notwithstanding the *coordinating entity* also provides information to demonstrate that the actual financial impact in the Jurisdiction of the Competent Authority is below the threshold in that paragraph.

2652. Where the *scope review panel*, *review panel* or *lead tax administration* adopts the proposal of a *listed party* or *affected party*, a revised recommendation shall be circulated to all *listed parties* or *affected parties* for a further round of written comments. In this case these comments are limited to aspects of the

recommendation that have changed and this is not an opportunity to raise further disagreements. Where any *listed party* or *affected party* does not agree to the revised recommendation, the disagreement shall be taken to a *determination panel* for an outcome under Article 27.

2653. Where the *scope review panel*, *review panel* or *lead tax administration* does not adopt the proposal, it may consult with the Competent Authority of the *listed party* or *affected party* for up to 30 days to explore whether the Competent Authority is still of the opinion that a change is needed or whether, in light of information that has been made available, it wishes to withdraw its written comments.

Section 2 – A determination panel to resolve disagreements

Paragraph 1

2654. For each issue put to it for resolution, a *determination panel* shall seek to agree by *consensus* including all panel members which alternative outcome is chosen from those provided for the panel to choose from. Where this is not possible, each *determination panel* members shall identify the alternative outcome which it considers represents the most correct application of the Convention. Where one alternative outcome is considered the most correct application of the Convention by more than one half of *determination panel* members, that alternative outcome is chosen by the panel.

Paragraph 2

2655. Where no alternative outcome is considered the most accurate application of the Convention by more than one half of *determination panel* members, all panel members shall rank the remaining outcomes in the order in which they consider the alternative outcomes to represent a correct application of the Convention. No alternative outcome may be excluded from this ranking, and no two alternative outcomes may be ranked equally. As a *determination panel* includes seven members including the Chair, this means that for each possible pair of alternative outcomes, one alternative outcome must always be preferred by a majority on the panel. An alternative outcome that is preferred over a second alternative outcome by a majority on the *determination panel* is said to be “majority preferred” over that second alternative outcome.

2656. Where a particular alternative outcome is majority preferred over all other alternative outcomes, that alternative outcome is chosen by the panel.

Paragraph 3

2657. Where no alternative outcome is majority preferred over all other alternative outcomes, paragraph 3 outlines a process to reduce the alternative outcomes that are available to be chosen from.

2658. First, under subparagraph (a)(i) the alternative outcome which is majority preferred over the highest number of other alternative outcomes shall be retained as an alternative outcome that may be chosen. In case of a tie, both or all of the alternative outcomes that are majority preferred over the same highest number of other alternative outcomes are retained.

2659. Next, under subparagraph (a)(ii), any alternative outcome that is majority preferred over any of the alternative outcomes retained under subparagraph (a)(i) is also retained as an alternative outcome that may be chosen. Then, under subparagraph (a)(iii), any alternative outcome that is majority preferred over any of the alternative outcomes retained under subparagraph (a)(ii) is also retained as an alternative outcome that may be chosen. This process continues until no alternative outcomes are added to those

retained. Remaining alternative outcomes are removed from the list of alternative outcomes that may be chosen.

2660. The effect of this process is that the original alternative outcomes presented to the *determination panel* have been separated into up to two groups. The first group, which contains one or more alternative outcomes each of which is majority preferred over each of the alternative outcomes in the second group, is retained as alternative outcomes that may be chosen by the *determination panel*. The second group, which includes any alternative outcomes that are not majority preferred over any of the alternative outcomes in the first group are not retained, and instead are removed from the list of alternative outcomes that may be chosen.

2661. The rankings of the remaining alternative outcomes are adjusted so as only to take into account the position of each remaining alternative outcome compared with the other remaining alternative outcomes. For example, if originally there were five alternative outcomes that were ranked 1 through 5 by each *determination panel* member, and these were reduced to a list of three alternative outcomes by the process in subparagraph (a)(i) through (iii), the rankings of the three remaining alternative outcomes by each *determination panel* member would be adjusted so that the relative ranking of each alternative outcome is retained, but they are now ranked 1 through 3 by each *determination panel* member.

2662. Next, under subparagraph (b) the extent to which each alternative outcome is considered the most accurate application of the Convention overall by *determination panel* members is taken into account. In doing so, the Chair shall compare the rankings of all of the remaining alternative outcomes and the remaining outcome that is ranked first as reflecting the most accurate application of the Convention by the lowest number of *determination panel* members shall also be removed from the list of alternative outcomes that may be chosen.

2663. In this situation, where the same lowest number of *determination panel* members consider more than one alternative outcome to be the most accurate application of the Convention (e.g. if two alternative outcomes are both ranked first by one *determination panel* member, and there are no alternative outcomes that were ranked first by no *determination panel* members), then the Chair shall eliminate the alternative outcome which, out of these alternative outcomes, is considered by the lowest number of *determination panel* members to be the second most accurate application of the Convention.

2664. Where the same lowest number of *determination panel* members consider more than one alternative outcome to be the second most accurate application of the Convention, the Chair shall eliminate the alternative outcome which, out of these alternative outcomes, is considered by the lowest number of *determination panel* members to be the third most accurate application of the Convention, and so on.

2665. This process is repeated until an alternative outcome is eliminated by the Chair. Where, having taken into account all levels of ranking, it is impossible to distinguish between the rankings of two or more alternative outcomes using this process (i.e. because the number of *determination panel* members that now have them placed at each level of ranking is identical), the Chair shall remove both or all of these alternative outcomes from the approaches that may be chosen. After this elimination, the rankings of each *determination panel* member are adjusted as if the remaining alternative outcomes were the only outcomes available to be chosen. The relative ranking of each alternative outcome by each *determination panel* member remains unchanged.

Paragraph 4

2666. Where, following the removal of one or more alternative outcomes from the options available to be chosen in paragraph 3, a particular remaining alternative outcome is ranked first as reflecting the most

accurate application of the Convention by a majority of *determination panel* members, that alternative outcome is chosen by the panel. Otherwise, the process in paragraph 3(b) is repeated to remove one or more alternative outcomes from those available to be chosen.

Paragraph 5

2667. The Chair shall repeat the process in paragraph 4 until one alternative outcome is ranked first as reflecting the most accurate application of the Convention by a majority of *determination panel* members and this alternative outcome is chosen by the panel.

Paragraph 6

2668. In a case where the general process in paragraphs 3 through 5 cannot identify a single alternative outcome chosen by the *determination panel*, for example because the relative rankings of the remaining alternative outcomes by members of the *determination panel* are the same, paragraph 6 provides a process for this tie to be broken.

2669. Under paragraph 6, for a single round, the process in paragraph 3(b) shall be performed with the rankings provided by the Chair of the *determination panel* disregarded. This will enable one or more remaining alternative outcomes to be eliminated. If, following this, no alternative outcome is ranked first as reflecting the most accurate application of the Convention by a majority of *determination panel* members, the process in paragraphs 3(b) through 5 shall resume, taking into account the rankings of all *determination panel* members, including the Chair.

2670. Because the *determination panel* comprises seven members and panel members are not permitted to rank alternative outcomes equally, the process in paragraph 6 should be used rarely, but it does ensure that the process described in Annex F Section 2 shall in all cases result in a single alternative outcome being chosen by the *determination panel*.

Box 90. Examples – Ranked choice voting

The examples below illustrate the approach in Section 2. These examples assume an issue to be resolved with more than two alternative outcomes. No alternative outcome is considered to represent the most accurate application of the Convention by more than one half of *determination panel* members. As such, all *determination panel* members have ranked the alternative outcomes in the order in which they consider them to reflect the most accurate application of the Convention. All alternative outcomes are included in these rankings and no alternative outcomes can be ranked equally by a *determination panel* member.

Example 1

In Example 1, the results of the *determination panel* members' rankings are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	4	3	1	3	2	5	3
Alt. Outcome 2	3	1	2	5	5	1	5

Alt. Outcome 3	2	5	4	4	1	2	1
Alt. Outcome 4	5	4	3	2	3	4	4
Alt. Outcome 5	1	2	5	1	4	3	2

The results for each possible pair of alternative outcomes are shown below. Where in a one-on-one contest the alternative outcome in the row header is majority preferred over the alternative outcome in the column header (based on the results in the above table), this is indicated by a ✓. Where the alternative outcome in the column header is majority preferred over the alternative outcome in the row header, this is indicated by a ✕.

	Alternative Outcome 1	Alternative Outcome 2	Alternative Outcome 3	Alternative Outcome 4	Alternative Outcome 5
Alt. Outcome 1	-	✓	✕	✓	✕
Alt. Outcome 2	✕	-	✕	✓	✕
Alt. Outcome 3	✓	✓	-	✓	✓
Alt. Outcome 4	✕	✕	✕	-	✕
Alt. Outcome 5	✓	✓	✕	✓	-

Based on this comparison of pairs of alternative outcomes, it can be seen that alternative outcome 3 is majority preferred over each of the other alternative outcomes. In other words, if the choice was between alternative outcome 3 and any other single alternative outcome, alternative outcome 3 would be chosen. As such, the process in Section 2 ends and alternative outcome 3 is chosen by the *determination panel*.

Example 2

In Example 2, the results of the *determination panel* members' rankings are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	3	2	5	4	4	4	3
Alt. Outcome 2	2	4	2	1	5	2	4
Alt. Outcome 3	5	5	3	5	1	1	2
Alt. Outcome 4	4	1	1	2	2	3	5
Alt. Outcome 5	1	3	4	3	3	5	1

The results for each possible pair of alternative outcomes are shown below. Where in a one-on-one contest the alternative outcome in the row header is majority preferred over the alternative outcome in the column header (based on the results in the above table), this is indicated by a ✓. Where the alternative outcome in the column header is majority preferred over the alternative outcome in the row

header, this is indicated by a ✖.

	Alternative Outcome 1	Alternative Outcome 2	Alternative Outcome 3	Alternative Outcome 4	Alternative Outcome 5
Alt. Outcome 1	-	✖	✖	✖	✖
Alt. Outcome 2	✓	-	✓	✓	✖
Alt. Outcome 3	✓	✖	-	✖	✖
Alt. Outcome 4	✓	✖	✓	-	✓
Alt. Outcome 5	✓	✓	✓	✖	-

Based on this comparison of pairs of alternative outcomes, it can be seen that no single alternative outcome is majority preferred over all of the other alternative outcomes. Therefore it is necessary for the Chair to identify which alternative outcomes should be retained and which should be removed from the list of alternative outcomes that may be chosen by the *determination panel*.

Alternative outcomes 2, 4 and 5 are each majority preferred over three other alternative outcomes. No other alternative outcome is majority preferred over a higher number of alternative outcomes. Therefore these three alternative outcomes are majority preferred over the highest number of other alternative outcomes and so are retained as alternative outcomes that the *determination panel* may choose.

Alternative outcome 1 is not majority preferred over any other alternative outcome. Alternative outcome 3 is majority preferred over alternative outcome 1, but no other alternative outcome. As neither alternative outcome 1 nor alternative outcome 3 is majority preferred over any of alternative outcomes 2, 4 or 5 (i.e. the alternative outcomes that have already been retained as alternative outcomes that the *determination panel* can choose), both of these alternative outcomes are removed from the list of alternative outcomes the *determination panel* may choose.

The original rankings of the remaining alternative outcomes 2, 4 and 5 by each *determination panel* member are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 2	2	4	2	1	5	2	4
Alt. Outcome 4	4	1	1	2	2	3	5
Alt. Outcome 5	1	3	4	3	3	5	1

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these three remaining alternative outcomes.

	<i>Determination panel</i> Members

Alternative Outcomes	A	B	C	D	E	F	G
Alt. Outcome 2	2	3	2	1	3	1	2
Alt. Outcome 4	3	1	1	2	1	2	3
Alt. Outcome 5	1	2	3	3	2	3	1

The Chair identifies the remaining alternative outcome that is considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, in order that this alternative outcome can also be removed from the list of alternative outcomes available to be chosen.

Alternative outcome 4 is considered to be the most accurate application of the Convention by three *determination panel* members. Alternative outcomes 2 and 5 are each considered to be the most accurate application of the Convention by two *determination panel* members. As both of these alternative outcomes are considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, for these alternative outcomes only, second place rankings are taken into account.

Alternative outcome 2 is considered to be the second most accurate application of the Convention by three *determination panel* members, while alternative outcome 5 is considered to be the second most accurate application of the Convention by two *determination panel* members. As such, alternative outcome 5 is removed from the list of alternative outcomes that the *determination panel* may choose.

The current rankings of the remaining alternative outcomes 2 and 4 by each *determination panel* member are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 2	2	3	2	1	3	1	2
Alt. Outcome 4	3	1	1	2	1	2	3

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these two remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 2	1	2	2	1	2	1	1
Alt. Outcome 4	2	1	1	2	1	2	2

Alternative outcome 2 is now considered to be the most accurate application of the Convention by four *determination panel* members, while alternative outcome 4 is considered to be the most accurate

application of the Convention by three *determination panel* members.

As, of the remaining alternative outcomes, alternative outcome 2 is considered to be the most accurate application of the Convention by a majority of *determination panel* members, this is the alternative outcome chosen by the *determination panel*.

Example 3

In Example 3, the results of the *determination panel* members' rankings are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	1	2	5	5	3	5
Alt. Outcome 2	2	3	5	2	4	4	1
Alt. Outcome 3	5	2	4	1	2	2	4
Alt. Outcome 4	3	5	1	3	1	1	3
Alt. Outcome 5	4	4	3	4	3	5	2

The results for each possible pair of alternative outcomes are shown below. Where in a one-on-one contest the alternative outcome in the row header is majority preferred over the alternative outcome in the column header (based on the results in the above table), this is indicated by a ✓. Where the alternative outcome in the column header is majority preferred over the alternative outcome in the row header, this is indicated by a ✗.

	Alternative Outcome 1	Alternative Outcome 2	Alternative Outcome 3	Alternative Outcome 4	Alternative Outcome 5
Alt. Outcome 1	-	✓	✗	✗	✓
Alt. Outcome 2	✗	-	✗	✓	✓
Alt. Outcome 3	✓	✓	-	✗	✓
Alt. Outcome 4	✓	✗	✓	-	✓
Alt. Outcome 5	✗	✗	✗	✗	-

Based on this comparison of pairs of alternative outcomes, it can be seen that no single alternative outcome is majority preferred over all of the other alternative outcomes. Therefore it is necessary for the Chair to identify which alternative outcomes should be retained and which should be removed from the list of alternative outcomes that may be chosen by the *determination panel*.

Alternative outcomes 3 and 4 are each majority preferred over three other alternative outcomes. No other alternative outcome is majority preferred over a higher number of alternative outcomes. Therefore these two alternative outcomes are majority preferred over the highest number of other alternative outcomes, and so are retained as alternative outcomes that the *determination panel* may choose.

Alternative outcome 2 is majority preferred over alternative outcome 4 (an alternative outcome that is

already retained as an alternative outcome that the *determination panel* may choose), so this alternative outcome is also retained as an alternative outcome that the determination may choose.

Further, alternative outcome 1 is majority preferred over alternative outcome 2 (an alternative outcome that is already retained as an alternative outcome that the *determination panel* may choose), so this alternative outcome is also retained as an alternative outcome that the determination may choose.

The last remaining alternative outcome, alternative outcome 5, is not majority preferred over any alternative outcome that has already been retained as alternative outcomes that the *determination panel* can choose. As such, this alternative outcome is removed from the list of alternative outcomes the *determination panel* may choose.

The original rankings of the remaining alternative outcomes 1, 2, 3 and 4 by each *determination panel* member are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	1	2	5	5	3	5
Alt. Outcome 2	2	3	5	2	4	4	1
Alt. Outcome 3	5	2	4	1	2	2	4
Alt. Outcome 4	3	5	1	3	1	1	3

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these four remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	1	2	4	4	3	4
Alt. Outcome 2	2	3	4	2	3	4	1
Alt. Outcome 3	4	2	3	1	2	2	3
Alt. Outcome 4	3	4	1	3	1	1	2

The Chair identifies the remaining alternative outcome that is considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, in order that this alternative outcome can also be removed from the list of alternative outcomes available to be chosen.

Alternative outcome 4 is considered to be the most accurate application of the Convention by three *determination panel* members. Alternative outcome 1 is considered to be the most accurate application of the Convention by two *determination panel* members. Alternative outcomes 2 and 3 are each considered to be the most accurate application of the Convention by one *determination panel* member. As both of these alternative outcomes are considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, for these alternative outcomes only,

second place rankings are taken into account.

Alternative outcome 2 is considered to be the second most accurate application of the Convention by two *determination panel* members, while alternative outcome 3 is considered to be the second most accurate application of the Convention by three *determination panel* members. As such, alternative outcome 2 is removed from the list of alternative outcomes that the *determination panel* may choose.

The current rankings of the remaining alternative outcomes 1, 3 and 4 by each *determination panel* member are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	1	2	4	4	3	4
Alt. Outcome 3	4	2	3	1	2	2	3
Alt. Outcome 4	3	4	1	3	1	1	2

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these three remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	1	2	3	3	3	3
Alt. Outcome 3	3	2	3	1	2	2	2
Alt. Outcome 4	2	3	1	2	1	1	1

Alternative outcome 4 is now considered to be the most accurate application of the Convention by four *determination panel* members, while alternative outcome 1 is considered to be the most accurate application of the Convention by two *determination panel* members and alternative outcome 3 is considered to be the most accurate application of the Convention by one *determination panel* member.

As, of the remaining alternative outcomes, alternative outcome 4 is considered to be the most accurate application of the Convention by a majority of *determination panel* members, this is the alternative outcome chosen by the *determination panel*.

Example 4

In Example 4, the results of the *determination panel* members' rankings are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	3	1	7	5	4	3

Alt. Outcome 2	4	1	5	6	4	1	2
Alt. Outcome 3	3	5	7	4	7	6	7
Alt. Outcome 4	2	4	6	3	6	7	4
Alt. Outcome 5	6	7	2	2	1	2	6
Alt. Outcome 6	7	2	4	1	3	3	5
Alt. Outcome 7	5	6	3	5	2	5	1

The results for each possible pair of alternative outcomes are shown below. Where in a one-on-one contest the alternative outcome in the row header is majority preferred over the alternative outcome in the column header (based on the results in the above table), this is indicated by a ✓. Where the alternative outcome in the column header is majority preferred over the alternative outcome in the row header, this is indicated by a ✕.

	Alternative Outcome 1	Alternative Outcome 2	Alternative Outcome 3	Alternative Outcome 4	Alternative Outcome 5	Alternative Outcome 6	Alternative Outcome 7
Alt. Outcome 1	-	✕	✓	✓	✓	✕	✓
Alt. Outcome 2	✓	-	✓	✓	✓	✓	✕
Alt. Outcome 3	✕	✕	-	✕	✕	✕	✕
Alt. Outcome 4	✕	✕	✓	-	✕	✕	✕
Alt. Outcome 5	✕	✕	✓	✓	-	✓	✓
Alt. Outcome 6	✓	✕	✓	✓	✕	-	✕
Alt. Outcome 7	✕	✓	✓	✓	✕	✓	-

Based on this comparison of pairs of alternative outcomes, it can be seen that no single alternative outcome is majority preferred over all of the other alternative outcomes. Therefore it is necessary for the Chair to identify which alternative outcomes should be retained and which should be removed from the list of alternative outcomes that may be chosen by the *determination panel*.

Alternative outcome 2 is majority preferred over five other alternative outcomes. No other alternative outcome is majority preferred over a higher number of alternative outcomes. Therefore alternative outcome 2 is majority preferred over the highest number of other alternative outcomes, and so is retained as an alternative outcome that the *determination panel* may choose.

Alternative outcome 7 is majority preferred over alternative outcome 2 (an alternative outcome that is already retained as an alternative outcome that the *determination panel* may choose), so this alternative outcome is also retained as an alternative outcome that the *determination panel* may choose.

Further, alternative outcomes 1 and 5 are each majority preferred over alternative outcome 7 (an alternative outcome that is already retained as an alternative outcome that the *determination panel* may choose), so these alternative outcomes are also retained as alternative outcomes that the *determination panel* may choose.

Going on, alternative outcome 6 is majority preferred over alternative outcome 1 (an alternative outcome that is already retained as an alternative outcome that the *determination panel* may choose), so this alternative outcome is also retained as alternative outcomes that the *determination panel* may choose.

The last remaining alternative outcomes, alternative outcomes 3 and 4, are not majority preferred over any alternative outcome that has already been retained as alternative outcomes that the *determination panel* can choose. As such, these alternative outcomes are removed from the list of alternative outcomes the *determination panel* may choose.

The original rankings of the remaining alternative outcomes 1, 2, 5, 6 and 7 by each *determination panel* member are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	3	1	7	5	4	3
Alt. Outcome 2	4	1	5	6	4	1	2
Alt. Outcome 5	6	7	2	2	1	2	6
Alt. Outcome 6	7	2	4	1	3	3	5
Alt. Outcome 7	5	6	3	5	2	5	1

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these five remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	3	1	5	5	4	3
Alt. Outcome 2	2	1	5	4	4	1	2
Alt. Outcome 5	4	5	2	2	1	2	5

Alt. Outcome 6	5	2	4	1	3	3	4
Alt. Outcome 7	3	4	3	3	2	5	1

The Chair identifies the remaining alternative outcome that is considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, in order that this alternative outcome can also be removed from the list of alternative outcomes available to be chosen.

Alternative outcomes 1 and 2 are each considered to be the most accurate application of the Convention by two *determination panel* members. Alternative outcomes 5, 6 and 7 are each considered to be the most accurate application of the Convention by one *determination panel* member. As these three alternative outcomes are each considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, for these alternative outcomes only, second place rankings are taken into account.

Alternative outcome 5 is considered to be the second most accurate application of the Convention by three *determination panel* members, while alternative outcomes 6 and 7 are each considered to be the second most accurate application of the Convention by one *determination panel* member. As such, for these two alternative outcomes, third place rankings are taken into account.

Alternative outcome 6 is considered to be the third most accurate application of the Convention by two *determination panel* members, while alternative outcome 7 is considered to be the third most accurate application of the Convention by three *determination panel* members. As such, alternative outcome 6 is removed from the list of alternative outcomes that the *determination panel* may choose.

The current rankings of the remaining alternative outcomes 1, 2, 5 and 7 by each *determination panel* member are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	3	1	5	5	4	3
Alt. Outcome 2	2	1	5	4	4	1	2
Alt. Outcome 5	4	5	2	2	1	2	5
Alt. Outcome 7	3	4	3	3	2	5	1

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these four remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	2	1	4	4	3	3
Alt. Outcome 2	2	1	4	3	3	1	2

Alt. Outcome 5	4	4	2	1	1	2	4
Alt. Outcome 7	3	3	3	2	2	4	1

Alternative outcomes 1, 2 and 5 are now each considered to be the most accurate application of the Convention by two *determination panel* members, while alternative outcome 7 is considered to be the most accurate application of the Convention by one *determination panel* member. As alternative outcome 7 is considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, this is removed from the list of alternative outcomes that the *determination panel* may choose.

The current rankings of the remaining alternative outcomes 1, 2, and 5 by each *determination panel* member are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	2	1	4	4	3	3
Alt. Outcome 2	2	1	4	3	3	1	2
Alt. Outcome 5	4	4	2	1	1	2	4

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these three remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	2	1	3	3	3	2
Alt. Outcome 2	2	1	3	2	2	1	1
Alt. Outcome 5	3	3	2	1	1	2	3

Alternative outcome 2 is now considered to be the most accurate application of the Convention by three *determination panel* members. Alternative outcomes 1 and 5 are each considered to be the most accurate application of the Convention by two *determination panel* members. As these two alternative outcomes are each considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, for these alternative outcomes only, second place rankings are taken into account.

Alternative outcomes 1 and 5 are each considered to be the second most accurate application of the Convention by two *determination panel* members. As such, third place rankings are also taken into account.

Alternative outcomes 1 and 5 are each considered to be the third most accurate application of the Convention by three *determination panel* members. This is the lowest remaining level of ranking. As,

having taken into account all levels of ranking, both of these alternative outcomes are considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, both of these alternative outcomes are removed from the list of alternative outcomes that may be chosen by the *determination panel*.

As, alternative outcome 2 is now the only remaining alternative outcome, this is the alternative outcome chosen by the *determination panel*.

Example 5

In Example 5, the results of the *determination panel* members' rankings are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	2	3	4	5	6	7
Alt. Outcome 2	2	3	4	5	6	7	1
Alt. Outcome 3	3	4	5	6	7	1	2
Alt. Outcome 4	4	5	6	7	1	2	3
Alt. Outcome 5	5	6	7	1	2	3	4
Alt. Outcome 6	6	7	1	2	3	4	5
Alt. Outcome 7	7	1	2	3	4	5	6

The results for each possible pair of alternative outcomes are shown below. Where in a one-on-one contest the alternative outcome in the row header is majority preferred over the alternative outcome in the column header (based on the results in the above table), this is indicated by a ✓. Where the alternative outcome in the column header is majority preferred over the alternative outcome in the row header, this is indicated by a ✗.

	Alternative Outcome 1	Alternative Outcome 2	Alternative Outcome 3	Alternative Outcome 4	Alternative Outcome 5	Alternative Outcome 6	Alternative Outcome 7
Alt. Outcome 1	-	✓	✓	✓	✗	✗	✗
Alt. Outcome 2	✗	-	✓	✓	✓	✗	✗
Alt. Outcome 3	✗	✗	-	✓	✓	✓	✗
Alt. Outcome 4	✗	✗	✗	-	✓	✓	✓

Alt. Outcome 5	✓	✗	✗	✗	-	✓	✓
Alt. Outcome 6	✓	✓	✗	✗	✗	-	✓
Alt. Outcome 7	✓	✓	✓	✗	✗	✗	-

Based on this comparison of pairs of alternative outcomes, it can be seen that no single alternative outcome is majority preferred over all of the other alternative outcomes. Therefore, it is necessary for the Chair to identify which alternative outcomes should be retained and which should be removed from the list of alternative outcomes that may be chosen by the *determination panel*.

All seven alternative outcomes are each majority preferred over three other alternative outcomes by a majority of panel members. Therefore, for purposes of this comparison, all seven alternative outcomes are majority preferred over the highest number of other alternative outcomes, and so are retained as alternative outcomes that the *determination panel* may choose.

The original rankings of the alternative outcomes by each *determination panel* member are shown below. As no alternative outcomes have been removed from the list of alternative outcomes that may be chosen by the *determination panel*, it is unnecessary to adjust these rankings to take into account only the remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	1	2	3	4	5	6	7
Alt. Outcome 2	2	3	4	5	6	7	1
Alt. Outcome 3	3	4	5	6	7	1	2
Alt. Outcome 4	4	5	6	7	1	2	3
Alt. Outcome 5	5	6	7	1	2	3	4
Alt. Outcome 6	6	7	1	2	3	4	5
Alt. Outcome 7	7	1	2	3	4	5	6

The Chair identifies the remaining alternative outcome that is considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, in order that this alternative outcome can also be removed from the list of alternative outcomes available to be chosen.

All seven alternative outcomes are each considered to be the most accurate application of the Convention by one *determination panel* member. Therefore, second place rankings are taken into account.

All seven alternative outcomes are also each considered to be the second most accurate application of the Convention by one *determination panel* member. Therefore, third place rankings are taken into account.

In this example, all seven alternative outcomes are also each considered to be the third most accurate, the fourth most accurate, the fifth most accurate, the sixth most accurate and the least accurate application of the Convention by one *determination panel* member. Therefore, even after taking into account all of the rankings by *determination panel* members, it is not possible at this stage to identify any alternative outcome to be removed from the list of alternative outcomes available to be chosen, unless all alternative outcomes were removed.

In order to address this tiebreak, this comparison is repeated, with the rankings of the Chair (in this case *determination panel* member A) disregarded. The original rankings of the alternative outcomes by each *determination panel* member that are to be taken into account are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 1	n/a	2	3	4	5	6	7
Alt. Outcome 2	n/a	3	4	5	6	7	1
Alt. Outcome 3	n/a	4	5	6	7	1	2
Alt. Outcome 4	n/a	5	6	7	1	2	3
Alt. Outcome 5	n/a	6	7	1	2	3	4
Alt. Outcome 6	n/a	7	1	2	3	4	5
Alt. Outcome 7	n/a	1	2	3	4	5	6

Alternative outcomes 2, 3, 4, 5, 6 and 7 are now each considered to be the most accurate application of the Convention by one *determination panel* member whose rankings are taken into account in this round. Alternative outcome 1 not considered to be the most accurate application of the Convention by any such *determination panel* member.

As such, alternative outcome 1 is removed from the list of alternative outcomes that the *determination panel* may choose.

The current rankings of the remaining alternative outcomes 2, 3, 4, 5, 6 and 7 by each *determination panel* member, including the Chair, are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 2	2	3	4	5	6	7	1
Alt. Outcome 3	3	4	5	6	7	1	2
Alt. Outcome 4	4	5	6	7	1	2	3

Alt. Outcome 5	5	6	7	1	2	3	4
Alt. Outcome 6	6	7	1	2	3	4	5
Alt. Outcome 7	7	1	2	3	4	5	6

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these six remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 2	1	2	3	4	5	6	1
Alt. Outcome 3	2	3	4	5	6	1	2
Alt. Outcome 4	3	4	5	6	1	2	3
Alt. Outcome 5	4	5	6	1	2	3	4
Alt. Outcome 6	5	6	1	2	3	4	5
Alt. Outcome 7	6	1	2	3	4	5	6

Alternative outcome 2 is now considered to be the most accurate application of the Convention by two *determination panel* members. Alternative outcomes 3, 4, 5, 6 and 7 are each considered to be the most accurate application of the Convention by one *determination panel* member. As each of these alternative outcomes are considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, for these alternative outcomes only, second place rankings are taken into account.

Alternative outcome 3 is considered to be the second most accurate application of the Convention by two *determination panel* members. Alternative outcomes 4, 5, 6 and 7 are each considered to be the second most accurate application of the Convention by one *determination panel* member. As each of these alternative outcomes are considered by the lowest number of *determination panel* members to be the second most accurate application of the Convention, for these alternative outcomes only, third place rankings are taken into account.

Alternative outcome 4 is considered to be the third most accurate application of the Convention by two *determination panel* members. Alternative outcomes 5, 6 and 7 are each considered to be the third most accurate application of the Convention by one *determination panel* member. As each of these alternative outcomes are considered by the lowest number of *determination panel* members to be the third most accurate application of the Convention, for these alternative outcomes only, fourth place rankings are taken into account.

Alternative outcome 5 is considered to be the fourth most accurate application of the Convention by two *determination panel* members. Alternative outcomes 6 and 7 are each considered to be the fourth most accurate application of the Convention by one *determination panel* member. As each of these alternative outcomes are considered by the lowest number of *determination panel* members to be the third most accurate application of the Convention, for these alternative outcomes only, fifth place rankings are taken

into account.

Alternative outcome 6 is considered to be the fifth most accurate application of the Convention by two *determination panel* members. Alternative outcome 7 is considered to be the fifth most accurate application of the Convention by one *determination panel* member. As such, alternative outcome 7 is removed from the list of alternative outcomes that the *determination panel* may choose.

The current rankings of the remaining alternative outcomes 2, 3, 4, 5 and 6 by each *determination panel* member are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 2	2	3	4	5	6	7	1
Alt. Outcome 3	3	4	5	6	7	1	2
Alt. Outcome 4	4	5	6	7	1	2	3
Alt. Outcome 5	5	6	7	1	2	3	4
Alt. Outcome 6	6	7	1	2	3	4	5

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these five remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 2	1	1	2	3	4	5	1
Alt. Outcome 3	2	2	3	4	5	1	2
Alt. Outcome 4	3	3	4	5	1	2	3
Alt. Outcome 5	4	4	5	1	2	3	4
Alt. Outcome 6	5	5	1	2	3	4	5

Alternative outcome 2 is now considered to be the most accurate application of the Convention by three *determination panel* members. Alternative outcomes 3, 4, 5 and 6 are each considered to be the most accurate application of the Convention by one *determination panel* member. As each of these alternative outcomes are considered by the lowest number of *determination panel* members to be the most accurate application of the Convention, for these alternative outcomes only, second place rankings are taken into account.

Alternative outcome 3 is considered to be the second most accurate application of the Convention by three *determination panel* members. Alternative outcomes 4, 5 and 6 are each considered to be the second most accurate application of the Convention by one *determination panel* member. As each of these alternative outcomes are considered by the lowest number of *determination panel* members to be

the second most accurate application of the Convention, for these alternative outcomes only, third place rankings are taken into account.

Alternative outcome 4 is considered to be the third most accurate application of the Convention by three *determination panel* members. Alternative outcomes 5 and 6 are each considered to be the third most accurate application of the Convention by one *determination panel* member. As each of these alternative outcomes are considered by the lowest number of *determination panel* members to be the third most accurate application of the Convention, for these alternative outcomes only, fourth place rankings are taken into account.

Alternative outcome 5 is considered to be the fourth most accurate application of the Convention by three *determination panel* members. Alternative outcome 6 is considered to be the fourth most accurate application of the Convention by one *determination panel* member. As such, alternative outcome 6 is removed from the list of alternative outcomes that the *determination panel* may choose.

The current rankings of the remaining alternative outcomes 2, 3, 4 and 5 by each *determination panel* member are shown below.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 2	2	3	4	5	6	7	1
Alt. Outcome 3	3	4	5	6	7	1	2
Alt. Outcome 4	4	5	6	7	1	2	3
Alt. Outcome 5	5	6	7	1	2	3	4

The rankings of these remaining alternative outcomes are now adjusted to take into account only the relative ranking of these four remaining alternative outcomes.

Alternative Outcomes	<i>Determination panel</i> Members						
	A	B	C	D	E	F	G
Alt. Outcome 2	1	1	1	2	3	4	1
Alt. Outcome 3	2	2	2	3	4	1	2
Alt. Outcome 4	3	3	3	4	1	2	3
Alt. Outcome 5	4	4	4	1	2	3	4

Alternative outcome 2 is now considered to be the most accurate application of the Convention by four *determination panel* members. Alternative outcomes 3, 4 and 5 are each considered to be the most accurate application of the Convention by one *determination panel* member.

As, of the remaining alternative outcomes, alternative outcome 2 is considered to be the most accurate application of the Convention by a majority of *determination panel* members, this is the alternative

outcome chosen by the *determination panel*.

Section 3 – Composition of a determination panel

Paragraph 1

2671. Annex F Section 3 provides for the more detailed operational and procedural rules regarding the composition of the *determination panel* that should be read with Article 28 while determining the composition of the panel in each individual case.

2672. Paragraph 1 provides details with respect to the establishment of a *standing pool* comprising *independent experts* who could act as *independent experts* in each *determination panel*. The *standing pool* shall be established immediately following entry into force of the Convention, to ensure that it is in place before the first possible *determination panel* arising from review processes. Subparagraph (a) states that the *standing pool* shall, from its time of establishment, include at least 150 individual *independent experts*, and that this number would be the *minimum pool size* for the *standing pool*, which would be maintained going forward as well. Subparagraph (a) also notes that the *standing pool* may also include individual *independent experts* nominated by new Parties to the Convention and clarifies that there is no limitation as to the maximum size of the *standing pool*.

2673. Subparagraph (b) provides that each Party may submit two nominations for the *standing pool*, without requiring any Party to necessarily submit nominations, thereby allowing Parties to either make no nominations or submit one or two nominations. These nominations must be for individuals who are willing to participate in the *determination panel* and fulfil the definition of *independent expert* as contained in paragraph 2, based on the knowledge of the nominating Party. The nominations shall be submitted to the Secretariat of the Conference of the Parties along with the names and detailed curriculum vitae of those individuals together with a statement explaining how they fulfil the requirements of an *independent expert* under paragraph 2. It is, however, clarified that there is no requirement that nominated individuals are residents or citizens of or have any connection with the nominating Party, so long as they meet the conditions described in paragraph 2. Subparagraph (c) provides that these nominations shall be submitted within 60 days of the entry into effect of the Convention for it and once the nominations are received, the Secretariat of the Conference of the Parties shall then communicate these nominations and accompanying documentation to the *screening committee* as soon as possible, to ensure that the nomination and screening process moves forward without undue delay. The *screening committee*, for this purpose, is defined in paragraph 4.

2674. Subparagraph (d) provides that once the nominations are received by the *screening committee*, the *screening committee* should decide whether the nominated individuals meet the conditions prescribed in paragraph 2 and whether they are suitable to act as *independent experts*. This decision should be taken by *consensus* or failing *consensus* within 30 days from the reference of the nominations, by *consensus-minus-one*. Although the *screening committee* is expected to take this decision based on the information that is placed in front of them, discretion is provided to the *screening committee* to agree on the suitability of the nominated individuals. Where the *screening committee* accepts the nomination of an individual as an *independent expert* in accordance with this subparagraph, the Secretariat of the Conference of the Parties shall then add such individual to a draft roster of the *standing pool* maintained by the Secretariat

of the Conference of the Parties. This draft roster shall form the basis for the establishment of the *standing pool*.

2675. Subparagraph (e) provides that the decision of the *screening committee* with respect to each nominated individual shall be communicated to the Party nominating such individual by the Secretariat of the Conference of the Parties within 60 days from the date of their nomination. Subparagraph (f) provides that within 30 days of the *screening committee* communication of its decision to not add a nominated individual to the *standing pool*, the Party nominating such individual may nominate one alternative individual for consideration as an *independent expert* in the *standing pool*. The new nomination received shall be subject to the same process for nomination into the *standing pool* as applicable to original nominations under this paragraph as well.

2676. Subparagraph (g) provides that if the total number of nominations received under subparagraph (b) are fewer than the *minimum pool size* or if the total number of *independent experts* in the *standing pool* drops below the *minimum pool size* for any other reason, the Secretariat of the Conference of the Parties shall invite each Party to nominate one additional *independent expert* each. The *screening committee* may add such nominated individuals to the draft roster of the *standing pool* as under subparagraph (d) to the extent required to meet the *minimum pool size*. However, to ensure that the *standing pool* does not have disproportionate representation for each Party, each Party shall have a maximum of four individuals nominated by it included in total to the draft roster of the *standing pool* at one time in general. However, to ensure that flexibility is maintained to allow the functioning of the *standing pool* as envisaged, it is also provided that the Conference of the Parties may agree to revise the number of additional nominations allowed or the maximum number of individuals that may be nominated by a Party in view of the total size and composition of the *standing pool*. The Conference of the Parties may also use this provision to allow additional nominations to renew the nomination of an *independent expert* following each individual's five-year term as noted in subparagraph (h) or to allow replacement nominations following an individual's five-year term, if this is not already addressed by the Secretariat of the Conference of the Parties owing to the *minimum pool size* not being met.

2677. Subparagraph (h) provides that once a nominated candidate is added to the draft roster of the *standing pool*, the details of that candidate shall be shared by the Secretariat of the Conference of the Parties with all Parties as soon as possible to allow for Parties to approve of these candidates before adding them to the *standing pool*. Accordingly, all Parties are allowed to object to the addition to the *standing pool* of a candidate in the draft roster of the *standing pool* solely on the grounds that they fail to meet one or more of the requirements in paragraph 2. If more than two-thirds of the Parties do not object to the addition of a candidate to the *standing pool* within 30 days of the sharing of the details of the candidate, the candidate shall be added to the *standing pool* for a period of five years and the Secretariat of the Conference of the Parties shall communicate this addition to the Parties as soon as possible thereafter. Similar to subparagraph (f), within 30 days of the communication by the Secretariat of the Conference of the Parties of a candidate not being added to the *standing pool* due to objections made under this subparagraph, the Party nominating the individual may nominate one alternative individual for consideration as an *independent expert* in the *standing pool* and the nomination received shall be subject to the same process for nomination into the *standing pool* as applicable to original nominations under this paragraph as well.

2678. Once individuals are added to the *standing pool*, subparagraph (i) allows for the possibility of an individual to be removed from the *standing pool* if they fail to meet the conditions in paragraph 2. Accordingly, if a Party establishes to the satisfaction of the *screening committee* that an individual in the *standing pool* fails to remain an *independent expert* under paragraph 2 at any time following their addition to the *standing pool*, the *screening committee* may recommend removal of that individual from the *standing pool*. All Parties are allowed to object to the removal of a candidate from the *standing pool*. If a simple

majority of the Parties do not object to the removal of a candidate from the *standing pool* within 30 days, the candidate shall be removed from the *standing pool*. Similar to subparagraphs (f) and (h), within 30 days of the *screening committee* communicating its decision to remove a nominated individual from the *standing pool*, the Party nominating the individual may nominate one alternative individual for consideration as an *independent expert* in the *standing pool*.

Paragraphs 2 through 4

2679. Paragraph 2 provides the definition of an *independent expert* and prescribes the conditions required for an individual to qualify as an *independent expert*. This paragraph notes that an individual would be considered an *independent expert* for purposes of Annex F Section 3 where the individual fulfils a number of conditions. First, the individual is required to be a person of standing, who may be relied upon to exercise independent judgment and conduct themselves in a professional manner. Second, the individual is required to have at least six years of relevant experience in corporate income tax matters. Third, the individual is required to have sufficient expertise in international taxation and/or financial accounting matters. These three conditions have been added to allow the *screening committee* discretion to consider the profile of the nominated individuals to ensure that their professional background makes them suitable to act as an *independent expert* in a *determination panel*, keeping in mind factors such as professional integrity, independence, objectivity, experience and expertise. Fourth, the individual does not work for and should not have worked for any government in the twelve months previous to their nomination, which would include time where they are seconded to any regional tax organisation or an *international organisation*. Fifth, the individual does not and has not during the previous twelve months, directly or on behalf of any enterprise or firm, provide(d) tax advisory services other than *limited tax advisory services*. For this purpose, the term *limited tax advisory services* is defined to include tax advisory services where the annual income earned by an individual from such services provided during the current year is less than 30 per cent of the individual's total annual income, including income from employment, contractual services, pensions or other retirement benefits, to ensure that individuals that provide occasional tax advisory services or retired tax advisors that provides such occasional services are covered in the definition. Finally, the individual does not work for a regional tax organisation or an *international organisation* that is not specified in the list provided in this paragraph. These conditions have been drafted to ensure that the *standing pool* of *independent experts* includes categories of experts such as academics, serving or retired judges, former tax officials, former tax advisors or professionals and officials from the agreed list of regional tax organisations or *international organisations* (as revised by an agreement of the Conference of the Parties in the future, as appropriate) so long as they are not on secondment from a government.

2680. Paragraph 3 provides the definition of a *government official* and prescribes the conditions required for an individual to qualify as a *government official*. This paragraph notes that an individual would be considered an *independent expert* for purposes of Annex F Section 3 where the individual is first, a person of standing and may be relied upon to conduct themselves in a professional manner (similar to paragraph 2), second, presently works for or on behalf of a function in the government of any Jurisdiction (irrespective of whether they are a Party or not), not being the tax audit and examination function in its tax administration, and has at least three years of relevant experience working in the field of international taxation or transfer pricing and has at least one year of relevant experience working for the government of that Jurisdiction and third, has sufficient expertise in international taxation and/or financial accounting matters (similar to paragraph 2).

2681. Paragraph 4 provides that a *screening committee* shall be established for the purposes of the *determination panel*. Each Party is allowed to nominate one individual for consideration to be a member of the *screening committee* every five years, with the first nomination being submitted within 30 days of the entry into effect of the Convention for the Party and subsequent nominations being submitted following a

call for nominations initiated by the Secretariat of the Conference of the Parties ever five years from the date of constitution of the first *screening committee*. Each nominated individual shall be a senior member in the government of that Party and shall provide a written statement indicating that individual's willingness to participate in the process and undertaking to act in an independent, impartial and transparent manner if selected to the Chair(s) of the Conference of the Parties. The Secretariat of the Conference of the Parties shall communicate these nominations to the Chair(s) of the Conference of the Parties as soon as possible thereafter. The Chair(s) of the Conference of the Parties shall, on each occasion when nominations are received from the Secretariat of the Conference of the Parties, following consultation with the Parties, make a proposal to all Parties for the composition of the *screening committee* for a term of five years, ensuring that the selected members have adequate seniority and objectivity, all geographical regions are adequately represented and Parties most likely to be affected by the outcomes in *determination panels* are adequately represented. Based on the proposal made by the Chair(s) of the Conference of the Parties, the composition of the *screening committee* shall be decided by all of the Parties by *consensus* or failing *consensus* within 30 days by two-thirds majority, for a term of five years from this decision. Since the *screening committee* plays a key role in ensuring that the *standing pool* comprises experts meet the conditions specified in paragraph 2 and have sufficient expertise, independence and objectivity to undertake their role as an *independent expert*, the Chair(s) of the Conference of the Parties shall pay due regard to views of all Parties obtained during consultations with respect to the *screening committee* and ensure that the composition of the *screening committee* represents the interests of all Parties, particularly with regard to different levels of development.

Paragraphs 5 through 9

2682. Paragraphs 5 and 6 provide for the mechanism for random selection of the individual members of the *determination panel* and/or the Chair under Section 3 and processes to be followed thereafter. Paragraph 6, in particular, notes that once selected, each *independent expert* should inform the Secretariat of the Conference of the Parties within 30 days whether they are willing to participate in the panel or are conflicted to act in a panel based on the definition in paragraph 12 and where they are willing, provide a signed statement concerning conflicts, which shall be shared with Parties.

2683. Paragraph 7 provides for situations where an *independent expert* selected at random from the *standing pool* shall be replaced at random, specifically in situations (i) where they are not willing or are conflicted to act in the panel, (ii) where an *affected party* can establish to the satisfaction of the *screening committee* within 30 days of communication of the signed statement that an individual is conflicted to act in a panel, (iii) where the same Party has another nominated *independent expert* in the same *determination panel* or (iv) where the individual is actively participating in three other *determination panels* at the time of selection.

2684. Paragraph 8 provides for rules to ensure that individuals that are nationals of a Party with no diplomatic relations with certain *affected parties* concerning a *determination panel* shall not act as an *independent expert* or *government official* in that *determination panel*. An *affected party* is covered in this provision where the *determination panel* deals with a change in the allocation of Amount A or the obligation to provide relief for Amount A under the Convention only for that *affected party*; or a change in the allocation of Amount A or the obligation to provide relief for Amount A under the Convention of the lower of 5 per cent or EUR 10 million for that *affected party*. In these cases, an *independent expert* would be replaced by another *independent expert* nominated by the same nominating Party, subject to the nomination process to the *standing pool* under paragraph 1, and a *government official* would be replaced by another *government official* falling under the same category of *government officials* in Article 28(1)(b), subject to the rules therein.

2685. Paragraph 9 provides that the Secretariat of the Conference of the Parties shall provide written confirmation to each selected *independent expert* and *government official* of their selection as soon as possible after the receipt of their signed statement, and subject to replacement if required, a signed copy of which would be returned to the Secretariat of the Conference of the Parties within 15 days of receipt. The *determination panel* shall be considered established on the date when the last of these signed copies is received by the Secretariat of the Conference of the Parties.

Paragraphs 10 through 15

2686. Paragraph 10 deals with the fees and expenses of the *independent experts* in a *determination panel*. Paragraph 10(a) provides that the fees of the *independent experts* of the *determination panel* appointed pursuant to Article 28, including the Chair shall be set at EUR 1000 per day. Paragraph 10(b) limits the reimbursement of expenses of the *independent experts* of the dispute resolution panel appointed pursuant to Article 28, including the Chair, in accordance with a standard schedule to be agreed by the Conference of the Parties and until such a schedule is agreed, in accordance with the average of the usual amount reimbursed to members of the staff of the competent authorities of the *listed parties* (for *determination panels* arising from *scope certainty reviews* or *follow-up scope certainty reviews*) or *affected parties* (for all other *determination panels*). This subparagraph seeks to limit the costs of *determination panel* proceedings in a manner consistent with the objective of providing timely resolution of *related issues* and the use of a last-best offer form of decision-making. Recognising that such a form of decision-making requires panel members only to choose between proposed resolutions, the paragraph provides that dispute resolution panel members appointed pursuant to Article 28, including the Chair, will only be compensated for a total of seven days (including both preparation and any possible meeting days). This time limit and the need to ensure limitation of costs involved also means that as far as possible, the *determination panel* shall use tele- and videoconferencing to communicate between themselves, using appropriate measures and facilities (such as encryption) to ensure the security and confidentiality of their communications, unless if a face-to-face meeting is considered necessary. In addition, paragraph 10(d) provides that because *government officials* appointed to the *determination panel* serve in their official capacity, they are not entitled to fees in addition to the remuneration they receive from their governments and are reimbursed for expenses in accordance with the rules generally applicable to a member of the staff of the relevant Competent Authority.

2687. To ensure oversight and accountability on the part of *independent experts*, especially since confidential information is concerned, paragraph 10(c) also provides that if the *relevant group* concerned by a *determination panel* is of the view that an *independent expert* did not act in line with their obligations under Part V Section 2 and with respect to confidentiality of information shared by such *relevant group* under the Convention in a *determination panel*, the *coordinating entity* of the *relevant group* may file a complaint to the *lead tax administration* within 60 days of a *determination panel* decision. If more than two-thirds majority of the *listed parties* (for *determination panels* arising from *scope certainty reviews* or *follow-up scope certainty reviews*) or *affected parties* (for all other *determination panels*) are of the view that the complaint has merit following consideration, no fee shall be payable and no expenses shall be reimbursed to such *independent expert* under this Section.

2688. Paragraph 11 provides that *independent experts* chosen for a *determination panel* under Part V Section 2 shall agree in writing, prior to the disclosure to them of any information relating to the *determination panel* proceeding, to treat such information consistently with the confidentiality and nondisclosure obligations described in the provisions of the Convention related to exchange of information and administrative assistance and under the applicable laws of all *listed parties* (for *determination panels* arising from *scope certainty reviews* or *follow-up scope certainty reviews*) or *affected parties* (for all other *determination panels*). In addition, paragraph 12 provides that if a *listed party* (for *determination panels* arising from *scope certainty reviews* or *follow-up scope certainty reviews*) or an *affected party* (for all other

determination panels) is of the view that an *independent expert* concerned by a *determination panel* did not act in line with their obligations under Part V Section 2 and with respect to confidentiality of information shared by such *relevant group* under the Convention in a *determination panel* prior to conclusion of proceedings, they may file a complaint to the *lead tax administration* at any time during the process. If more than a simple majority of the *listed parties* (for *determination panels* arising from *scope certainty reviews* or *follow-up scope certainty reviews*) or *affected parties* (for all other *determination panels*) do not object within 30 days of the complaint, the *independent expert* in question selected from the *standing pool* shall be replaced with another *independent expert* selected at random from the *standing pool*, respectively.

2689. Paragraph 13 deals with how the total cost of fees and expenses payable to *independent experts* on *determination panels* will be met. This cost will be met from two sources: from the total *tax certainty user fees* paid by *coordinating entities* when making a request for certainty under Article 22 or 23; and from contributions from Parties. The level of *tax certainty user fees* and contributions will be determined such that, over time and in aggregate, the total *tax certainty user fees* paid by *coordinating entities* will equal 50 per cent of the total fees and expenses of *independent experts* on *determination panels*. *Tax certainty user fees* paid by *coordinating entities* shall not be used for any other purpose.

2690. The level of *tax certainty user fees* shall be agreed by the Conference of the Parties. Where over time and in aggregate the total *tax certainty user fees* paid by *coordinating entities* is more than or less than 50 per cent of the total fees and expenses of *independent experts* on *determination panels*, and the Conference of the Parties does not expect this situation to correct over time, the Conference of the Parties may agree to increase or reduce the level of *tax certainty user fees* payable in the future accordingly. For example, if a surplus or shortfall of *tax certainty user fees* accrues over time, it may be necessary to reduce or increase the level of future *tax certainty user fees*, as least temporarily, in order to utilise this surplus, or remove this shortfall. Fees and expenses payable to *independent experts* on *determination panels* that are not met by the total *tax certainty user fees* paid by *coordinating entities* shall be met by contributions from Parties. Paragraph 14 contains the *cost sharing allocation key* to be used to determine the contribution of each Party. This is based on a percentage of the average gross domestic product of a Party for the five immediately preceding years. These percentages are:

- for a high income Jurisdiction, 100 per cent;
- for an upper-middle income Jurisdiction, 75 per cent;
- for a lower-middle income Jurisdiction, 50 per cent; and
- for a low income Jurisdiction, 40 per cent.

The income level of a Party is determined using the classifications published most recently by the World Bank prior to the first day of the relevant year. These classifications are based on the *gross national income* per capita of a Jurisdiction determined using the World Bank Atlas Method. By linking the contributions of a Party both to GDP and to *gross national income* per capita, this ensures that the contribution of each Party takes into account both the size of a Party's economy and the level of income in that economy.

2691. Finally, paragraph 15 provides definitions of certain terms used in Annex F Section 3. While definitions particular to Section 3 including the conflict conditions described in subparagraph (b) are provided in this paragraph, subparagraph (b) provides that each *independent expert* appointed to the dispute resolution panel pursuant to Article 28, including the Chair, must, at the time of accepting their appointment, fulfil certain requirements to ensure their impartiality and independence with respect to the specific case. In particular, an individual is conflicted to act on a *determination panel* involving the *relevant group* where at the time of appointment:

- The individual or a Family Member (defined in Article 2(t)) is or was an employee, contractor, partner or member of any member of the *relevant group*, in the previous five years, or continues to derive benefits of any kind from such engagements or relationships that existed in any prior Period.
- The individual or a Family Member is or was a *significant investor* (defined in subparagraph 15(d)) in the *relevant group* or any of its Entities, in the previous two years, or continues to derive benefits of any kind from such investments in any prior period.
- The individual or a Family Member has or had *significant business dealings* (defined in subparagraph 15(e)) with any member of the *relevant group* in the previous five years or continue to derive benefits of any kind from such transactions or activities in any prior Period.
- The individual, directly or as part of or on behalf of an enterprise or firm, is or was personally involved in providing, or supervising the provision of tax, advisory, consulting, accounting or audit services to the *relevant group* or any of its Entities in the previous five years.
- The individual, directly or as part of or on behalf of an enterprise or firm, is or was personally involved in providing, or supervising the provision of tax, advisory, consulting, accounting or audit services to the *relevant group* or any of its Entities with respect to an arrangement or transaction being considered by the *determination panel*. This requirement is not subject to any temporal limitation (i.e., an individual will always be considered to have a conflict with respect to an arrangement or transaction with which they were personally involved).
- The individual or a Family Member holds or held a *funded academic position* (defined in subparagraph 15(c)) in the previous five years, or continues to derive benefits of any kind from such engagements or relationships that existed in any prior Period.

2692. For determining whether the conflict rules with respect to Family Members above apply, the individual would need to declare under paragraph 6 whether they are aware, to the best of their knowledge, of their Family Members being involved in the activities referred to in the list above.

Section 4 – Definitions

2693. Annex F Section 4 includes examples of the documentation that a Party may use to confirm that it is a Jurisdiction in which a Group has or is likely to have Adjusted Revenues above the nexus threshold in Article 8 in a Period. This list is illustrative only, and a Party may also choose to rely on different documentation depending upon what is available and relevant to a particular case.

Annex G – Supplementary provisions on tax certainty for issues related to Amount A

Section 1 – Statement of information and Terms of Reference

Paragraphs 1 and 2

2694. Paragraphs 1 and 2 are intended to facilitate the effective conduct of dispute resolution panel proceedings through the development by the *MAP competent authorities* of documentation to reflect basic information about the case and to frame the issues for decision by the dispute resolution panel.

2695. Paragraph 1 provides that, within 30 days of the request for a dispute resolution panel pursuant to Article 35(1), the *MAP competent authorities* shall agree a brief statement of information that identifies the Entities of the Covered Group directly affected by the case and contains a general description of the *related issues* to be resolved in the case. This statement of information will be used to determine whether prospective dispute resolution panel members satisfy the eligibility requirements identified in Annex G Section 3 as they relate to independence and impartiality.

2696. Paragraph 12 requires the *MAP competent authorities* to agree, within 60 days of a request for a dispute resolution panel pursuant to Article 35(1), *terms of reference* for the case. These *terms of reference* shall include:

- a description of the relevant business activities of the Covered Group;
- a description of the *related issues* in dispute in the case;
- a description of the matters to be considered for the resolution of the case, including identification of all matters in the case previously agreed between the *MAP competent authorities*; and
- a description of the final position taken by each *MAP competent authority* in the discussion of the unresolved matters that prevent mutual agreement by the *MAP competent authorities*.

These *terms of reference* may also include logistical or procedural information.

2697. The *terms of reference* are intended to frame the issues for decision by a dispute resolution panel and thereby contribute to an efficient and effective panel process. The purpose of the inclusion in the *terms of reference* of the final position taken by each *MAP competent authority* in the MAP discussion of unresolved *related issues* is to contribute to discipline and transparency in both MAP discussions and the dispute resolution panel process; Article 35(2)(a)(iv) also supports the default rule in Annex G Section 5(h) that applies when a *MAP competent authority* does not submit a proposed resolution to the dispute resolution panel by the deadline provided in Annex G Section 5(a).

2698. The *terms of reference* are to be communicated to the Chair on the date of his or her appointment, or as soon thereafter as possible. If the *terms of reference* have not been agreed by the date for submission of the proposed resolutions and position papers provided in Annex G Section 5, both *MAP competent authorities* shall send to each other and to the Chair their most recent written proposals for the *terms of reference* at the same time they submit their proposed resolutions and position papers to the Chair. All the matters identified as unresolved in each of these proposals for the *terms of reference* shall be treated as unresolved for purposes of the subsequent proceedings. Where these proposals for the *terms of reference*

reflect a disagreement regarding whether an unresolved issue is a *related issue*, the dispute resolution panel shall resolve that disagreement, as provided in Article 35(1)(b).

Section 2 – Competent authority agreement on mode of application

2699. Part V Section 3 sets out the core provisions related to the dispute resolution panel mechanism, as well as default rules to ensure that the key structural elements of the process are in place, and is intended to permit the dispute resolution panel mechanism to function without the requirement of additional bilateral *MAP competent authority* mutual agreements. Annex G Section 2 recognises, however, that the *covered jurisdictions* may wish to settle certain aspects of the mode of application of the provisions in Part V Section 3 by mutual agreement, in light of the wide variety of legal and tax systems, and the fact that each *MAP competent authority* relationship is unique. The smooth functioning of the dispute resolution panel process will require close collaboration by the *MAP competent authorities*. Consultation and agreement on additional procedural and operational details of the process may help to ensure its effective implementation and proper functioning. Where appropriate, *MAP competent authority* mutual agreements concluded pursuant to Annex G Section 2 could establish agreed guidelines for the conduct of dispute resolution panel proceedings, which could include, for example, provisions on the working language of dispute resolution panels. Where a pair of *covered jurisdictions* wish to limit the application of the dispute resolution procedure under Article 35 to a restricted range of cases in general, by excluding a category of cases from the scope of the dispute resolution procedure, this may be covered in a *MAP competent authority* agreement under Section 2 as well.

2700. As recognised by paragraphs 50 through 52 of the Commentary on Article 25 of the OECD Model, treaty provisions based on Article 25(3) provide *MAP competent authorities* with broad authority to resolve difficulties of application of the treaty by means of mutual agreement. Such authority includes the authority to supplement treaty provisions providing for dispute resolution mechanisms such as the Article 35 dispute resolution panel mechanism or the OECD Model Article 25(5) MAP arbitration mechanism. Article 35(10) expressly confirms in the MLC that the *MAP competent authorities* of the *covered jurisdictions* may by mutual agreement settle the mode of application of Article 35 – that is, that the *MAP competent authorities* may by mutual agreement supplement the procedural and operational details provided by Article 35, with a view to ensuring that the dispute resolution panel mechanism most effectively achieves its objectives. Where a Jurisdiction's domestic law would limit its *MAP competent authority's* exercise of the authority to conclude mutual agreements pursuant to Annex G Section 2 or to provisions based on Article 25(3) of the OECD Model or the UN Model, it is expected that its *MAP competent authority* would only conclude mutual agreements with treaty partner *MAP competent authorities* pursuant to Annex G Section 2 to the extent that such mutual agreements were consistent with such domestic law limitations.

Section 3 – Appointment of dispute resolution panel members

2701. Annex G Section 3 sets out basic rules for the composition of a dispute resolution panel and the appointment and qualifications of dispute resolution panel members. While these rules apply by default, Annex G Section 3 also permits the *MAP competent authorities* of two *covered jurisdictions* to mutually agree on different rules that will apply with respect to MAP cases that involve those two *covered jurisdictions*, either generally or with respect to a particular case. The provision will thus allow Jurisdictions that, for example, prefer dispute resolution panels comprising only independent experts, or dispute resolution panels comprising only government officials, to agree bilaterally to so adapt these rules.

2702. Under Annex G Section 3(a), the dispute resolution panel is composed of five individual panel members. Annex G Section 3(b) provides that each *MAP competent authority* shall, within 60 days of the request for a dispute resolution panel, appoint one panel member from the staff of that *MAP competent authority* and one panel member from the list of independent experts established by that *MAP competent authority* in accordance with Annex G Section 3(g). The four dispute resolution panel members appointed pursuant to Annex G Section 3(b) must, within 30 days of the latest of their appointments, appoint a Chair from the persons on the lists of independent experts nominated by both *MAP competent authorities* under Annex G Section 3(g) who have indicated their willingness to serve as Chair. Failing agreement between the four members within this 30 day period, the two independent panel members appointed from the lists of independent experts must then, within another 30 days, appoint a fifth member from the persons on the lists of independent experts nominated by both *MAP competent authorities* who is not a national or resident of either *covered jurisdiction* to serve as Chair of the dispute resolution panel. Unless the *MAP competent authorities* agree otherwise, there is no requirement that any member of the dispute resolution panel have experience as a judge or an arbitrator.

2703. Annex G Section 3(c) establishes when a member of the dispute resolution panel is considered to have been appointed, which is relevant for purposes of certain deadlines (such as those provided in Annex G Section 3(b) and Section 5).

2704. Annex G Section 3(d) and (e) describe default rules that apply where either *MAP competent authority* fails, within the prescribed time periods, to appoint a member of the dispute resolution panel, or where the two independent panel members appointed from the lists of independent experts fail to appoint a Chair.

2705. Annex G Section 3(d) provides for the consequences where a *MAP competent authority* fails to make the appointments provided in Annex G Section 3(b) by the applicable deadline.

2706. In the case of a failure to appoint the member from the staff of the *MAP competent authority* under Annex G Section 3(b)(i), the dispute resolution panel shall proceed with neither a panel member from the staff of that *MAP competent authority* or a panel member appointed by that *MAP competent authority* pursuant to Section 3(b)(ii), to ensure that an odd number of panel members is maintained in the dispute resolution panel.

2707. In the case of a failure to appoint the member from the list of independent experts under Annex G Section 3(b)(ii), the *MAP competent authority* of the other *covered jurisdiction* shall appoint panel members at random from the individuals on the list of independent experts nominated by the first-mentioned *MAP competent authority* under Annex G Section 3(g).

2708. Annex G Section 3(e) then provides that where the independent experts cannot agree a Chair of the panel by the applicable deadline, the *MAP competent authorities* shall appoint the Chair at random from the individuals on the lists of independent experts nominated by both *MAP competent authorities* who have indicated their willingness to serve as the Chair.

2709. The default rules in Annex G Section 3(d) and (e) are intended to ensure that the dispute resolution panel process, and therefore a resolution of *related issues* in a mutual agreement procedure case, cannot be unduly delayed by a failure to constitute a dispute resolution panel. As default rules, these rules will apply only to the extent that the *MAP competent authorities* of the relevant *covered jurisdictions* have not mutually agreed on different rules.

2710. Annex G Section 3(f) provides that – except to the extent that the *MAP competent authorities* of the relevant *covered jurisdictions* have mutually agreed on different rules – each independent expert

appointed to the dispute resolution panel pursuant to Annex G Section 3(b)(ii) and the Chair must, at the time of accepting their appointment, fulfil the requirements set out in Annex G Section 3(g) and fulfil certain other requirements to ensure their impartiality and independence with respect to the specific MAP case. In particular, an individual is conflicted to act on a dispute resolution panel involving the Covered Group where at the time of appointment:

- The individual or a Family Member is or was an employee, contractor, partner or member of the Covered Group or any of its Entities, in the previous five years, or continues to derive benefits of any kind from such engagements or relationships that existed in any prior period.
- The individual or a Family Member is or was a *significant investor* in the Covered Group or any of its Entities, in the previous two years, or continues to derive benefits of any kind from such investments in any prior period.
- The individual or a Family Member has or had *significant business dealings* with any Entity of the Covered Group in the previous five years or continues to derive benefits of any kind from such transactions or activities in any prior period.
- The individual, directly or as part of or on behalf of an enterprise or firm, is or was personally involved in providing, or supervising the provision of, tax, advisory, consulting, accounting or audit services to the Covered Group or any of its Entities in the previous five years.
- The individual, directly or as part of or on behalf of an enterprise or firm, is or was personally involved in providing, or supervising the provision of, tax, advisory, consulting, accounting or audit services with respect to an arrangement or transaction at issue in the MAP case. This requirement is not subject to any temporal limitation (i.e., an individual will always be considered to have a conflict with respect to an arrangement or transaction with which they were personally involved).
- The individual or a Family Member holds or held a *funded academic position* in the previous five years, or continues to derive benefits of any kind from such engagements or relationships that existed in any prior period.

2711. For determining whether the conflict rules with respect to Family Members above apply, the individual would need to declare under this subparagraph (as noted in paragraph 2712) whether they are aware, to the best of their knowledge, of their Family Members being involved in the activities referred to in the list above. Each of these panel members must also maintain their impartiality and independence throughout the proceedings, and must for a reasonable period of time thereafter avoid conduct that may damage the appearance of impartiality and independence of the members of the dispute resolution panel with respect to the proceedings. Such conduct would include, for example, accepting employment with a member of the Covered Group, or its advisors, soon after delivering the dispute resolution panel decision. Prospective dispute resolution panel members will undertake to disclose to both *MAP competent authorities*, in writing, any facts or circumstances that arise during or subsequent to the panel proceedings that might call into question their impartiality or independence.

2712. Each panel member will execute a written certification to the effect of the provisions of Annex G Section 3(f).

2713. Annex G Section 3(g) provides rules for the establishment of the lists of independent experts from which (pursuant to Annex G Section 3(b)) certain members of dispute resolution panels will be appointed. For the purpose of constituting these lists of independent experts, the *MAP competent authority* of each *covered jurisdiction* shall nominate five individuals who –

- may be relied upon to exercise independent judgment and conduct themselves in a professional manner;
- have at least six years of experience in dealing with international corporate income tax and/or transfer pricing; and
- do not work for or on behalf of any Government and were not in such a situation at any time during the previous twelve months, irrespective of whether the individual is/was on secondment to a regional tax organisation or an *international organisation* during this time (for purposes of Part V Section 3, an individual who has accepted an appointment as a member of any other panel provided for under the Convention, or as an arbitrator in a proceeding pursuant to Part VI of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting or pursuant to the provisions of any other bilateral or multilateral agreement or domestic law provision providing for the arbitration or resolution of unresolved issues in a MAP case, will not be considered based on such appointment to work for or on behalf of, or to have worked for or on behalf of, the Government of a *covered jurisdiction*).

2714. The establishment of the lists of independent experts is intended to provide transparency with respect to the individuals that a *MAP competent authority* would appoint to a dispute resolution panel pursuant to Annex G Section 3(b)(ii) and to facilitate the choice of a Chair. It is expected that each *MAP competent authority* will screen the individuals it nominates as that *MAP competent authority* will have already familiarised itself with those individuals' background and other relevant facts as part of the process of identifying suitable nominees. There is no requirement under Annex G Section 3(g) that a *MAP competent authority* nominate five different individuals for purposes of each of its bilateral treaty relationships, nor does Annex G Section 3(g) include requirements to update or change these individuals at specific intervals. A *MAP competent authority* may, for example, prefer to maintain a single standing list of independent experts for all of a *covered jurisdiction's* bilateral relationships. *MAP competent authorities* should, however, keep in mind that the Chair of a particular dispute resolution panel shall be appointed from among the individuals on the list of independent experts who are not nationals or residents of either of the relevant *covered jurisdictions*. In addition, *MAP competent authorities* should periodically verify that the nominated individuals remain eligible to serve as independent experts and are not deceased or otherwise incapable of serving on a dispute resolution panel.

2715. Pursuant to Annex G Section 3(h), each *MAP competent authority* shall confirm with each person it nominates that person's willingness to serve as a member of a dispute resolution panel, including (in cases where the independent expert is neither a national or resident of either *covered jurisdiction*) whether that person would be willing to serve as Chair. In all cases, at least one independent expert nominated by each *covered jurisdiction* shall not be a national or resident of either relevant *covered jurisdiction* and shall be willing to serve as Chair (for purposes of the appointment of a Chair of the dispute resolution panel pursuant to Annex G Section 3(b) or (e)). Each *MAP competent authority* shall inform the other *MAP competent authority* of the independent experts so nominated. A *MAP competent authority* shall be entitled to object to a person nominated by the other *MAP competent authority* only where that person does not meet the requirements provided in Annex G Section 3(g) and shall provide a justification with any such objection. The other *MAP competent authority* should take these objections into account and nominate a different person where the justification provided makes it clear that the requirements provided in Annex G Section 3(g) are not met by the nominated person. The *MAP competent authorities* may also settle the mode of application of this provision specifically through a *MAP competent authority* agreement as referred to in Annex G Section 2 to ensure that disagreements do not arise with respect to whether nominated individuals meet these requirements. Each *covered jurisdiction* may change the persons so nominated and shall notify the other *MAP competent authority* without delay when it wishes to do so.

2716. Annex G Section 3(i) provides a default rule that is designed to prevent blockages of the dispute resolution panel mechanism in two specific circumstances: (i) where one or both *MAP competent authorities* fail to nominate any individuals to a list of independent experts used to select dispute resolution panel members appointed pursuant to Annex G Section 3(b)(ii) and the Chair; or (ii) where none of the individuals nominated by a *MAP competent authority* to a list of independent experts meets the requirements of Annex G Section 3(f) or is otherwise available to act as a member of a dispute resolution panel in a particular case. In these circumstances, the group of individuals nominated by the relevant *MAP competent authority* to the *standing pool* comprising *independent experts* established for purposes of Amount A *determination panels* under Annex F Section 3, shall be used for purposes of the appointment on behalf of that *MAP competent authority* of a dispute resolution panel member pursuant to Annex G Section 3(b)(ii) and for purposes of the appointment of the Chair (with the two panel members appointed pursuant to Annex G Section 3(b)(ii) taking into account that the Chair shall not be a national or resident of either *covered jurisdiction*). Where no individuals have been nominated by the *covered jurisdiction* concerned to the *standing pool* or where none of the individuals nominated by a *covered jurisdiction* to this *standing pool* is eligible to act as an independent expert under this Section, all individuals in the *standing pool* under Annex F Section 3 other than those nominated by the *covered jurisdiction* of the other *MAP competent authority* shall be used for purposes of the appointment on behalf of that *MAP competent authority* of a dispute resolution panel member under this Section.

2717. Annex G Section 3(j) addresses situations in which a dispute resolution panel member is unable to perform his or her duties, as a result of illness or incapacity, failing to meet standards for impartiality and independence, or for any other reason. It provides that the procedures in Annex G Section 3 shall apply with the necessary adaptations if for any reason it is necessary to replace a dispute resolution panel member after the dispute resolution panel process has begun. In such circumstances, the *MAP competent authorities* shall also agree on necessary adaptations, as appropriate, to the deadlines provided in Annex G Section 5. *MAP competent authorities* may mutually agree on alternative arrangements to replace dispute resolution panel members, bearing in mind the overall objective of timely resolution of *related issues*.

2718. Finally, Annex G Section 3(k) provides definitions of certain terms used in Annex G Section 3(f) to establish when a person from the list of independent experts provided in Annex G Section 3(g) is considered to have a conflict at the time of appointment, as noted in Annex G Section 3(f), that would prevent that person from serving on a dispute resolution panel in a particular case.

Section 4 – Communication of information and confidentiality of dispute

Resolution panel proceedings

Paragraph 1

2719. To ensure that the dispute resolution panel process can accomplish its purpose without undermining the confidentiality of the mutual agreement procedure, it is important that the *MAP competent authorities* be permitted to provide the members of the dispute resolution panel with relevant information, subject to the same strict confidentiality requirements that would apply to the *MAP competent authorities* themselves. To accomplish this, Annex G Section 4(1) provides that, solely for purposes of Article 35, and of the provisions of *covered tax agreements*, the Convention, and the domestic laws of the *covered jurisdictions* related to the exchange of information, confidentiality, and administrative assistance, the members of the dispute resolution panel shall be considered persons or authorities to whom information may be disclosed.

2720. Pursuant to Annex G Section 4(1), such information may also be disclosed to prospective dispute resolution panel members, but solely to the extent necessary to verify their ability to fulfil the requirements of dispute resolution panel members, including, for example, their independence and impartiality. Annex G Section 4(1) additionally provides that information received by the dispute resolution panel or by prospective dispute resolution panel members, as well as any information that the *MAP competent authorities* may receive from the dispute resolution panel, shall be considered information exchanged under the exchange of information and administrative assistance provisions of the relevant agreement. Recognising the need to balance the goal of minimising the number of people to whom information may be disclosed against dispute resolution panel members' need for staff support, this paragraph also provides for disclosure under the same conditions to a maximum of three staff per panel member.

Paragraph 2

2721. Annex G Section 4(2) requires the *MAP competent authorities* to ensure that prospective dispute resolution panel members from the lists of independent experts provided in Annex G, Section 3(g) agree in writing, prior to the disclosure to them of any information relating to the dispute resolution panel proceeding, to treat such information consistently with the confidentiality and nondisclosure obligations described in the provisions of the relevant agreement related to exchange of information and administrative assistance and under the applicable laws of the *covered jurisdictions*. *MAP competent authorities* must also ensure that members of the dispute resolution panel from the lists of independent experts provided in Annex G Section 3(g) and their staff agree in writing, prior to their acting in an dispute resolution panel proceeding, to treat any information relating to the proceeding consistently with the confidentiality and nondisclosure requirements under the provisions of the relevant agreement related to the exchange of information and administrative assistance and under the applicable laws of the *covered jurisdictions*. Annex G Section 4(2) includes a mechanism for the *MAP competent authority* that appointed the dispute resolution panel member to obtain such a written agreement from the dispute resolution panel member and their staff. Either *MAP competent authority* may obtain the written agreement from the Chair and their staff.

2722. The consequences for a member of a dispute resolution panel or a prospective dispute resolution panel member who breaches such a written agreement would be determined under the applicable domestic laws of the *covered jurisdictions* and under the terms of the agreement itself (for example, the agreement may provide that a dispute resolution panel member shall be dismissed and shall forfeit any remuneration to which that member would otherwise be entitled in the event of a breach of the agreement's confidentiality provisions). The consequences for a member of a dispute resolution panel or a prospective dispute resolution panel member under the applicable domestic law may be determined by courts or other bodies, besides or in addition to the *MAP competent authorities*. In the event that a member of a dispute resolution panel or a prospective dispute resolution panel member breaches this agreement, the *MAP competent authorities* shall by mutual agreement determine the consequences of that breach on the dispute resolution panel proceeding itself, which could, for example, include the replacement of one or more members of the dispute resolution panel in circumstances where the dispute resolution panel proceeding is still ongoing.

Paragraph 3

2723. Annex G Section 4(3) requires the *MAP competent authorities*, prior to the start of a dispute resolution panel proceeding, to ensure that each member of a Covered Group involved in the case and their authorised representatives or advisors agree in writing not to disclose any of the information received during the course of the dispute resolution panel proceeding from either *MAP competent authority* or from the dispute resolution panel, other than the determination of the panel where that disclosure is required under the laws of any Jurisdiction. Such a disclosure could be required, for example, for purposes of

financial reporting by the Covered Group or by securities regulations, and may be required in a Jurisdiction other than one of the two *covered jurisdictions* involved in the MAP case (for example, in a third Jurisdiction in which the Covered Group's parent entity is resident).

2724. A breach of the agreement provided in Annex G Section 4(3) between the time at which the request for a dispute resolution panel was made and before the dispute resolution panel has delivered its decision will result in the termination of the mutual agreement procedure and the dispute resolution panel proceeding with respect to the case. Where such a breach occurs subsequent to the dispute resolution panel's delivery of its decision, the *MAP competent authorities* shall by mutual agreement determine the consequences of the breach with respect to the dispute resolution panel proceeding and its outcomes.

2725. It is expected that *MAP competent authorities* would take a practical approach in determining the consequences of a breach of Annex G, Section 4(2) or (3) on the dispute resolution panel proceeding (which would apply in addition to the consequences for dispute resolution panel members under the applicable domestic laws of the *covered jurisdictions*). Such an approach should balance the need to maintain the integrity of the dispute resolution panel process and the objective of achieving timely resolution of *related issues*.

Section 5 – Dispute resolution panel process

2726. Annex G Section 5, provides default rules for the decision-making process that will be used in dispute panel proceedings pursuant to Article 35. The provision also permits the *MAP competent authorities* of the *covered jurisdictions* to mutually agree on different rules for the decision-making process, which may apply to all cases or to a particular case. In the absence of such an agreement, however, the decision-making process described in Annex G Section 5 will apply.

2727. Dispute resolution panels will, by default, apply a last-best offer (also known as final offer) approach to decision-making. Under this approach, the *MAP competent authorities* will each submit to the dispute resolution panel a proposed resolution that addresses all of the unresolved *related issues* in the case in a manner consistent with any previous agreements that have been reached in that case by the *MAP competent authorities*. For each adjustment or similar issue in the case, the proposed resolution will generally include only the disposition of specific monetary amounts (for example, of income or expense). In some cases, however, unresolved *related issues* will include questions regarding whether the conditions for applying a provision of a *covered tax agreement* have been met. Where the unresolved *related issues* in a case include such a “threshold question”, such as whether an enterprise of one of the *covered jurisdictions* has a permanent establishment in the other *covered jurisdiction*, the *MAP competent authorities* may submit their proposed answers to the *threshold question* (i.e. yes or no). If there are other unresolved *related issues* the disposition of which is contingent on the answer reached with respect to the *threshold question*, it is expected that the *MAP competent authorities* would also submit alternative proposed resolutions of those remaining *related issues*.

2728. Pursuant to the introductory language of Annex G Section 5, the *MAP competent authorities* of two *covered jurisdictions* may mutually agree to use an alternative form of decision-making, such as an independent opinion approach, whether in a specific case or in general. As noted above, however, last-best offer decision-making will apply in all circumstances in the absence of such a mutual agreement. *MAP competent authorities* that come to such a mutual agreement should keep in mind that certain alternative forms of decision-making (such as an independent-opinion approach) may be expected to lengthen the period of time required by a dispute resolution panel to deliver its decision. Those *MAP competent authorities* should thus also consider the interactions with the time periods provided for different steps in

the dispute resolution panel process, or with respect to the *terms of reference*, keeping in mind the overall objective of the mechanism to provide a timely resolution of *related issues*. As provided in Annex G Section 5(j), the dispute resolution panel decision shall have no precedential value notwithstanding a *MAP competent authority* mutual agreement to use an alternative form of decision-making, and any rationale or explanation provided in connection with such decision-making would not create precedent for the resolution or decision of other cases.

2729. The proposed resolutions submitted by the *MAP competent authorities* of each *covered jurisdiction* may be supported by a position paper. Each proposed resolution and any supporting position paper must be submitted for consideration by the dispute resolution panel by the date on which the proposed resolution is due (i.e., within 60 days of the appointment of the Chair of the dispute resolution panel, as provided in Annex G Section 5(a)).

2730. The proposed resolution shall not exceed five pages. The supporting position paper shall not itself exceed 30 pages but may be supported by annexes. The supporting position paper should contain a complete and concise explanation of the *MAP competent authority's* proposed resolution. Annexes to the supporting position paper should provide factual information as background to supplement the proposed resolution and should not contain additional arguments not set out in the supporting position paper.

2731. Each *MAP competent authority* submits its proposed resolution solely to the Chair. The Chair will then provide copies of both proposed resolutions to the two *MAP competent authorities* concurrently, as soon as possible following the date of receipt of the latest of the proposed resolutions. This process for the communication of proposed resolutions is intended to ensure a level playing field as between the *MAP competent authorities* by informing each *MAP competent authority* of the other's position and arguments at the same time. Supporting position papers and reply submissions are similarly communicated by the *MAP competent authorities* solely to the Chair, who then provides copies of these documents concurrently to both *MAP competent authorities*. Where, however, the provisions of Annex G Section 5(h) apply, Annex G Section 5(a) provides that the Chair will provide copies of the proposed resolutions and supporting position papers to both *MAP competent authorities* only at the end of the seven-day period provided in Annex G Section 5(h). At that time, the Chair will inform both *MAP competent authorities* if the *MAP competent authority* that was provided additional time to submit a proposed resolution and/or a supporting position paper did not do so.

2732. The *MAP competent authorities* must at the same time provide the Chair with portions of the request for a mutual agreement procedure submitted by the Covered Group that are relevant to the unresolved *related issues*. *MAP competent authorities* should consult and preferably agree on the relevant portions of a Covered Group's request that are provided to the Chair. The Covered Group should ensure that the different issues raised in its MAP request are clearly demarcated in order to allow the *MAP competent authorities* to extract such relevant portions. The Covered Group should also ensure that MAP requests are concise and succinct, in order to allow such portions to inform the dispute resolution panel of the original position of the member of a Covered Group. The *MAP competent authorities* should clearly indicate in a covering letter along with this submission that the portions of the MAP request shared with the Chair should not be considered an alternative position or proposed resolution that is submitted for consideration by the dispute resolution panel.

2733. Each *MAP competent authority* may also submit a reply submission with respect to the proposed resolution and supporting position paper submitted by the other *MAP competent authority*. A reply submission must be submitted for consideration by the dispute resolution panel within 60 days of the date on which the proposed resolution and supporting position paper were due. The reply submission is meant to address only the positions and arguments of the other *MAP competent authority*, and a *MAP competent authority* should not advance additional arguments in favour of its own position in a reply submission. In

circumstances where a *MAP competent authority* has not submitted a proposed resolution within the additional seven-day period provided in Annex G Section 5(h), the other *MAP competent authority* shall consider the relevant *MAP competent authority* position described in the *terms of reference* pursuant to Annex G Section 1(2)(a)(iv) as that *MAP competent authority's* proposed resolution for purposes of any reply submission. A *MAP competent authority* that has not submitted a proposed resolution may submit a reply submission but, as noted above, should not use a reply submission to advance its own arguments or position.

2734. The reply submission shall not exceed ten pages but may be supported by annexes. The reply submission should contain a complete and concise response to the positions and arguments set out in the other *MAP competent authority's* proposed resolution and supporting position paper. Like the annexes to the supporting position paper, annexes to the reply submission should only provide factual information as background to supplement the reply submission.

2735. Annex G Section 5(d) further provides that any annex to a supporting position paper or reply submission which does not reflect publicly available information must be a document previously made available for the *MAP competent authorities* of both *covered jurisdictions* to use in discussion of the mutual agreement procedure case. Moreover, any factual information used in a supporting position paper or reply submission which does not reflect publicly available information must be contained in a document previously made available for both *MAP competent authorities* to use in discussion of the mutual agreement case.

2736. Under Annex G Section 5(e), the *MAP competent authority* of a *covered jurisdiction* is permitted to refer in materials submitted to a dispute resolution panel to a proposal for resolution previously made by either *MAP competent authority* during discussion of the MAP case only if that proposal is submitted to the dispute resolution panel for consideration as a proposed resolution or if that position is described in the *terms of reference* pursuant to Annex G Section 1(2)(a)(iv). A reply submission prepared pursuant to Annex G Section 5(c) will necessarily refer to the proposed resolution submitted by the other *MAP competent authority*. The final position taken by each *MAP competent authority* in the MAP discussion of the *related issues* will be provided to the dispute resolution panel as part of the *terms of reference*, and it may accordingly be appropriate for a *MAP competent authority* to refer to that final position in its submissions to a dispute resolution panel. In the context of the dispute resolution panel process, reference to other positions taken by a *MAP competent authority* may create uncertainty or confusion, given the binary nature of a dispute resolution panel's decision. The restrictions provided by Annex G Section 5(e) would not apply to the *MAP competent authorities*, however, in the context of their bilateral MAP discussions of the case, which may continue at the same time as a dispute resolution panel proceeding.

2737. The *MAP competent authorities* may mutually agree on different rules with respect to the proposed resolutions, position papers, and reply submissions, including their maximum length and their content, in any agreement on the mode of application of the dispute resolution panel procedure entered into pursuant to Annex G Section 2.

2738. Annex G Section 5(f) permits the dispute resolution panel to request additional factual information from the *MAP competent authorities* within 60 days after the deadline for receipt of the proposed resolutions from both *MAP competent authorities*. Such additional information may be submitted to the panel only at its request, and the panel will establish a deadline for responding to the request. Such requests for additional information may only concern information that consists of, or is reflected in, existing documentation; the dispute resolution panel may not request additional information not previously available or considered for purposes of the discussion of the mutual agreement procedure case. The dispute resolution panel may not request new or additional analyses from the *MAP competent authorities*. The panel is not permitted to request additional information from any member of the Covered Group that

presented the case. The *MAP competent authorities* shall consult with each other to determine how to respond to any request from the panel for additional information and, prior to providing the additional information to the panel, shall mutually agree on the form and content of the response.

2739. Although *MAP competent authorities* should generally not encounter difficulties in agreeing a response that reflects solely factual information reflected in existing documentation, there may be circumstances in which they disagree with respect to specific aspects of the form or content of the response. In these circumstances, Annex G Section 5(f)(ii) provides that, by the deadline established by the panel, the *MAP competent authorities* shall provide the Chair with a joint (i.e., agreed) response that reflects items with respect to which the *MAP competent authorities* agree and that identifies those items with respect to which the *MAP competent authorities* disagree. By that deadline, each *MAP competent authority* shall also provide the Chair and the other *MAP competent authority* with a supplementary response that addresses only those items with respect to which the *MAP competent authorities* disagree. These supplementary responses shall not contain any new or additional analyses in support of a *MAP competent authority's* proposed resolution.

2740. Pursuant to the last-best offer approach to decision-making, the dispute resolution panel will select as its decision one of the proposed resolutions submitted by the *MAP competent authorities*. In a case involving one or more *threshold questions*, the dispute resolution panel will decide the *threshold question(s)*, and then adopt one of the alternative proposed resolutions submitted by the *MAP competent authorities*. The dispute resolution panel will deliver its decision to the *MAP competent authorities* of the *covered jurisdictions* within 180 days of the appointment of the Chair of the dispute resolution panel. The decision will be adopted by a simple majority of the dispute resolution panel members. The decision of the dispute resolution panel will be delivered in writing by the Chair to the *MAP competent authorities* of the *covered jurisdictions*.

2741. In the event that the *MAP competent authority* of one of the *covered jurisdictions* fails to submit a proposed resolution and/or a supporting position paper to the Chair of the dispute resolution panel within the time period provided in Annex G Section 5(a), the Chair shall notify both *MAP competent authorities*. The *MAP competent authority* that did not submit a proposed resolution and/or a supporting position paper shall be provided 7 additional days to submit a proposed resolution and/or a supporting position paper to the Chair. Where the relevant *MAP competent authority* does not submit a proposed resolution within this seven-day period, the dispute resolution panel shall consider the relevant *MAP competent authority* position described in the *terms of reference* pursuant to Annex G Section 1(2)(a)(iv) as that *MAP competent authority's* proposed resolution. This rule is intended to avoid the possibility that one *MAP competent authority* could block the dispute resolution panel process by not submitting a proposed resolution to the dispute resolution panel.

2742. Within 100 days after the receipt of the dispute resolution panel decision, the *MAP competent authority* of the *covered jurisdiction* of residence of the member of a Covered Group that requested the dispute resolution panel proceeding shall communicate to that member of the Covered Group in writing the proposed *MAP competent authority* resolution of the case that reflects the outcome of the dispute resolution panel decision. That member of a Covered Group shall confirm in writing within 30 days that it and all other Entities of the Covered Group directly affected by the case accept the proposed *MAP competent authority* resolution. The failure of the member of a Covered Group that requested the dispute resolution panel proceeding to indicate the acceptance of the proposed *MAP competent authority* resolution by all Entities of the Covered Group directly affected by the case within 30 days shall be considered a rejection of the proposed *MAP competent authority* resolution.

2743. The requirement that the member of a Covered Group accept the proposed *MAP competent authority* resolution reflects the circumstance that MAP cases in which *related issues* arise are as a formal

matter resolved through a *MAP competent authority* mutual agreement. In general, if the terms and conditions of any MAP resolution are not satisfactory to the taxpayer¹⁰, the taxpayer may be entitled to withdraw from the MAP process and pursue other domestic remedies that are still available. The requirement that the member of a Covered Group accept the proposed *MAP competent authority* resolution is thus a recognition that the dispute resolution panel process is not an alternative or additional recourse but an extension of the mutual agreement procedure that serves to ensure the timely resolution of MAP cases. The resolution of the case continues to be reached through the mutual agreement procedure, whilst the resolution of the *related issues* that are preventing agreement in the case are handled through the dispute resolution panel process. This distinguishes the dispute resolution panel process from other forms of commercial or government-private party arbitration where the Jurisdiction of the panel extends to resolving the whole case. In practice, it is expected that the member of a Covered Group will typically accept the proposed *MAP competent authority* resolution because, once implemented, it will ensure taxation in accordance with the Convention, including appropriate relief from double taxation, in both *covered jurisdictions*.

2744. In light of the limited purpose of dispute resolution panels to provide a streamlined method for resolving disputes between the *MAP competent authorities* with respect to *related issues*, the decision of the dispute resolution panel will not have precedential value (i.e., the decision of the dispute resolution panel shall not establish a precedent with respect to *related issues* for any other case or taxable years). Whilst the decisions of the dispute resolution panel will not have precedential value, *MAP competent authorities* may wish to consider whether it is appropriate to extend the terms of the resolution of the case to cover subsequent Periods, in particular where the facts and circumstances of the relevant transactions or activities remain unchanged. This may facilitate the resolution of recurring issues that could otherwise give rise to multiple, duplicative MAP cases. Depending on the *MAP competent authorities'* MAP practices and procedures, the terms of the resolution could potentially be extended by mutual agreement to subsequent Periods for which the member of a Covered Group has filed tax returns (but with respect to which it has not filed MAP requests) or reflected in a bilateral advance pricing arrangement for future years. Any decision to extend the terms of the resolution to subsequent Periods would in all cases remain subject to the discretion of the *MAP competent authorities*, based on the facts and circumstances of those subsequent Periods.

2745. Annex G Section 5(k) provides that when the Chair determines that the dispute resolution panel will be unable to deliver its decision to the *MAP competent authorities* of the *covered jurisdictions* by the deadline provided in Annex G, Section 5(i), the Chair is required to notify both *MAP competent authorities* as soon as possible, informing them of the reasons for delay. In most cases, it is expected that providing the dispute resolution panel with additional time will permit the dispute resolution panel to reach a decision, and Annex G Section 5(k) expressly recognises that the *MAP competent authorities* may mutually agree to do so. The *MAP competent authorities* may also mutually agree to take any other appropriate measures to facilitate the panel's decision, which could include, for example, an oral explanation by one *MAP competent authority* of points in its proposed resolution that were unclear or raised questions. In agreeing to provide the dispute resolution panel with additional time, or to any other measures they consider appropriate, the *MAP competent authorities* should keep in mind the binary nature of the last-best offer decision-making process and the overall objective of timely resolution of *related issues*.

¹⁰ In most cases, a taxpayer cannot accept the terms of an agreement reached through the MAP for only some issues or taxation years involved, unless both Competent Authorities agree. This is due to the fact that the Competent Authorities commonly consider the original request by the taxpayer, which is usually multifaceted, in its entirety and often consider all aspects (issues and taxation years) involved at one time and as one case, and ultimately one outcome. The resolution of contentious MAP cases may be the result of compromise and concessions and, therefore, Competent Authorities routinely use a holistic approach.

2746. Finally, Annex G Section 5(l) is a catch-all provision that permits the dispute resolution panel, to the extent needed, to propose any additional procedures necessary for the conduct of its business, provided that these procedures are not inconsistent with the Article or any other procedural rules agreed by the *MAP competent authorities*. Any such additional procedures remain subject to the approval, by mutual agreement, of the *MAP competent authorities*. The Chair shall provide a written copy of any proposed additional procedures to the *MAP competent authorities*.

Section 6 – Costs of dispute resolution panel proceedings

Paragraph 1

2747. Annex G Section 6(1) addresses the distribution of the costs of dispute resolution panel proceedings and reflects the following general principles:

- Each *covered jurisdiction* bears the costs related to the participation of its own *MAP competent authority* in the dispute resolution panel proceedings. These costs would generally relate to the *MAP competent authority* resources needed to prepare the *MAP competent authority* position and any reply submissions, which it is expected would be based on work that the *MAP competent authorities* had already carried out for purposes of their discussion of the mutual agreement procedure case in the period before the request for a dispute resolution panel. Because the dispute resolution panel process would usually use tele- and videoconferencing facilities to the extent possible, a typical dispute resolution panel process will not involve any travel costs. Where, however, the *MAP competent authorities* mutually agree that a face-to-face meeting is necessary, each *MAP competent authority* will bear the travel costs related to its participation in such a meeting.
- Each *covered jurisdiction* bears the fees and expenses of the members of the dispute resolution panel appointed by that *covered jurisdiction's MAP competent authority*, or appointed on behalf of that *MAP competent authority* as a result of that *MAP competent authority's* failure to appoint those dispute resolution panel members, together with those dispute resolution panel members' travel, telecommunication and secretarial¹¹ costs. As noted above, a typical dispute resolution panel process will not involve any travel costs, but each *MAP competent authority* would bear the travel costs of the members of the dispute resolution panel it appointed (or appointed on its behalf) in the event that the *MAP competent authorities* mutually agree an in-person meeting of the panel is necessary.
- The remuneration of the Chair of the dispute resolution panel and the Chair's travel, telecommunication and secretarial costs are borne by the *covered jurisdictions* in equal shares. As noted above, a typical dispute resolution panel process will not involve any travel costs, but the *MAP competent authorities* would bear equally the travel costs of the Chair of the dispute resolution panel in the event that the *MAP competent authorities* mutually agree an in-person meeting of the panel is necessary.

¹¹ The "secretarial costs" referred to here are costs related to secretarial or administrative activities to support members of the panel in performing their duties (for example, routine document preparation). Where the panel members do not themselves perform these activities, they would typically be performed by member of the panel member's staff, such as an administrative assistant. It is anticipated that any secretarial costs would be *de minimis*.

- Other costs related to any meeting of the dispute resolution panel are borne by the *covered jurisdiction* that hosts that meeting. Such other costs would generally be understood to include internal costs associated with the logistical arrangements for the meetings of the dispute resolution panel, such as the use of meeting facilities maintained by a *covered jurisdiction*, related resources, financial management, other logistical support provided by the *MAP competent authority* of a *covered jurisdiction*, and general administrative coordination of the proceedings. These other costs would not include travel costs, as those costs are dealt with in the preceding provisions.
- Any other costs related to expenses that both *covered jurisdictions* have agreed to incur are borne in equal shares by the two *MAP competent authorities*. Such costs could include, for example, costs to translate documentation for members of the dispute resolution panel or for interpretation during dispute resolution panel proceedings. In many cases, however, *covered jurisdictions* may already require the taxpayer to provide, at its expense, translations of documentation related to a MAP request that was not prepared in the working language(s) of the tax administration. The provisions of Annex G, Section 6(1)(a)(v) would not preclude a *MAP competent authority* from charging back to the member of a Covered Group costs such as translation costs allocated to that *MAP competent authority* under Annex G, Section 6(1)(a)(v) in a manner consistent with its established practices and procedures. A *MAP competent authority* should, however, seek to clearly provide in its MAP programme guidance any general requirements related to a taxpayer's translation of documentation related to a MAP request.

2748. The introductory language of Annex G, Section 6(1) expressly recognises that the *MAP competent authorities* of two *covered jurisdictions* may agree to different rules for the distribution of the costs of dispute resolution panel proceedings. Such different rules may be particularly appropriate in circumstances where the two *covered jurisdictions* are at significantly different stages of development, or where one *covered jurisdiction* is a low-capacity jurisdiction.

2749. Annex G Section 6(1) also provides that the *MAP competent authorities* of the *covered jurisdictions* may mutually agree that the member of the Covered Group that requested the dispute resolution panel shall bear the costs related to a dispute resolution panel proceeding in appropriate circumstances. Annex G Section 6(1)(b) sets out an illustrative list of circumstances in which *MAP competent authorities* may mutually agree that the member of the Covered Group will bear these costs, which might generally include cases in which the dispute resolution panel has reached a decision but that decision is not binding, or where a member of the Covered Group has not respected obligations it has undertaken as part of the dispute resolution panel process. This list identifies in particular:

- where a court of one of the *covered jurisdictions* holds that the dispute resolution panel decision is invalid in the circumstances described in Article 35(2)(b)(ii) and that holding is motivated, in whole or in part, by the conduct of an Entity of the Covered Group directly affected by the case; or
- where an Entity of the Covered Group directly affected by the case or one of its authorised representatives or advisors breaches the confidentiality agreement provided in Annex G, Section 4(1).

2750. It would generally not be appropriate for a member of a Covered Group to bear costs related to a dispute resolution panel proceeding if that member of a Covered Group withdraws its request for a dispute resolution panel at the request of both *MAP competent authorities*. The explanation of Article 35(12) describes a situation in which a member of a Covered Group requests a dispute resolution panel but soon thereafter is informed by the *MAP competent authorities* that they expect to reach an agreed resolution of the MAP case shortly. Although the dispute resolution panel proceeding would terminate pursuant to Article 35(12)(a)(i) upon a *MAP competent authority* mutual agreement, the *MAP competent authorities* would

continue to be bound by the provisions of Article 35 to take certain actions by fixed deadlines until that mutual agreement was concluded. *MAP competent authorities* may thus prefer to ask the member of the Covered Group to withdraw the request for a dispute resolution panel in view of an imminent mutual agreement, the date of which they will not know with absolute certainty, in order to avoid being obliged to set up a dispute resolution panel that would likely not be used. In such circumstances, it would generally not be appropriate for the member of the Covered Group to bear the costs (if any) of the dispute resolution panel.

2751. However, Annex G Section 6(1)(c) clarifies that the member of a Covered Group that requested the dispute resolution panel will be required to bear costs amounting to the lower of half of the fees, expenses and costs of the independent expert members of the dispute resolution panel appointed by or on behalf of the *MAP competent authorities* as well as the Chair or a total amount of EUR 15,000, where an Entity of the Covered Group directly affected by the case does not accept, or is considered not to accept, the proposed *MAP competent authority* resolution concerning the case that reflects the outcome of the dispute resolution panel decision. Even though the dispute resolution procedure is only invoked where cases remain unresolved in the mutual agreement procedure, members of a Covered Group that invoke the dispute resolution procedure should generally accept the outcome arising from the procedure. Although this paragraph generally provides that Covered Groups are not required to bear any costs where tax certainty is provided, where the Covered Group does not accept the outcome as determined by a dispute resolution panel and tax certainty is thus not provided through the process, the Covered Group is required to bear part of the cost to the extent that this is not an excessive burden as defined under paragraph 1(c) and detailed above. However, it is clarified that since this is intended to only cover exceptional cases where the Covered Group would not like to move forward with the tax certainty that is provided, the Covered Group's legal recourse to the remedy under Article 35 should not be considered affected by this paragraph. The *MAP competent authorities* involved may agree on administrative mechanisms to implement this paragraph.

Paragraph 2

2752. Annex G Section 6(2) provides that the fees of the members of the dispute resolution panel appointed pursuant to Annex G, Section 3(b)(ii) or (d) and the Chair shall be set with reference to a schedule of fees to be mutually agreed and periodically updated, as appropriate, by the *MAP competent authorities* of the *covered jurisdictions*. In light of the importance of clear rules for this purpose to avoid obstacles to the dispute resolution panel process that may arise as a result of disagreements related to dispute resolution panel member compensation or expenses, Annex G Section 6(2) includes a default rule that applies in the absence of a *MAP competent authority* mutual agreement. Pursuant to Annex G Section 6(2)(a), that default rule provides that such fees shall be set at EUR 1000 per day.

2753. Different points of reference may be used to establish the fees of the members of the dispute resolution panel appointed pursuant to Annex G Section 3(b)(ii) or (d) and the Chair. One alternative is the International Centre for Settlement of Investment Disputes (ICSID) Schedule of Fees for arbitrators¹². *Covered jurisdictions* may also wish to explore alternative arrangements to reflect the particular circumstances of the *covered jurisdictions* and their bilateral relationship.

2754. Annex G Section 6(2)(b) limits the reimbursement of expenses of the members of the dispute resolution panel appointed pursuant to Annex G Section 3(b)(ii) or (d) and the Chair to the average of the

¹² The ICSID Schedule of Fees is available at: <https://icsid.worldbank.org/services/content/schedule-fees>. See also the Memorandum on the Fees and Expenses of ICSID Arbitrators (available at <https://icsid.worldbank.org/services/content/memorandum-fees-expenses>) for a detailed explanation of how the fees and expenses ICSID arbitrators are calculated.

usual amount reimbursed to members of the staff of the *MAP competent authorities* of the *covered jurisdictions* concerned. As under Annex G Section 6(2)(a), the introductory language of Annex G Section 6(2) expressly recognises that the *MAP competent authorities* of two *covered jurisdictions* may mutually agree to some other method or scale to determine the reimbursement of expenses to members of the dispute resolution panel.

2755. Because members of the dispute resolution panel appointed pursuant to Annex G Section 3(b)(i) serve in their official capacity, they are not entitled to fees in addition to the remuneration they receive as a member of the staff of the *MAP competent authority* of the relevant *covered jurisdiction* and are reimbursed for expenses in accordance with the rules generally applicable to a member of the staff of the relevant *MAP competent authority*.

2756. Annex G Section 6(2) seeks to limit the costs of dispute resolution panel proceedings in a manner consistent with the objective of providing timely resolution of *related issues* and the use of a last-best offer form of decision-making. Recognising that such a form of decision-making requires dispute resolution panel members only to choose between two proposed resolutions, the paragraph provides that dispute resolution panel members appointed pursuant to Annex G Section 3(b)(ii) or (d) and the Chair will only be compensated for a total of five days (three days of preparation and two meeting days).

2757. If the dispute resolution panel considers that it requires additional time to properly consider the case, Annex G Section 6(2) provides that the Chair will contact the *MAP competent authorities* to request additional time. The *MAP competent authorities* shall then by mutual agreement determine how to respond to such a request.

Paragraph 3

2758. In recognition of the additional costs involved with the dispute resolution panel mechanism, Annex G Section 6(3) contains a commitment by the *covered jurisdictions* that their *MAP competent authorities* will mutually agree on an appropriate multilateral framework to fund the costs of Parties that are low-capacity developing countries related to dispute resolution panel proceedings, including under the elective binding dispute resolution mechanism provided by Article 36. Annex G Section 6(3) provides that such a multilateral *MAP competent authority* agreement shall be concluded before the date on which unresolved *related issues* in a mutual agreement procedure case are first eligible to be submitted to a dispute resolution panel under Article 35 or 36, and may be modified from time to time thereafter.

Annex H – Review process and early clarification on digital services taxes and relevant similar measures

Paragraphs 1 through 10

2759. Annex H(1) through (9) establish a process for the Conference of the Parties to determine whether a measure in the Jurisdiction of a Party (the “enacting Party”) is a “digital services tax or relevant similar measure” described under Article 39(2). Where this is the case, allocations of Amount A Profits are eliminated for that Party in accordance with Article 39(1) and as described in Annex H(10).

2760. The process is launched when a Party (referred to as the “requesting Party”) makes a request, pursuant to paragraph 1, for a meeting of the Conference of the Parties to be convened in order to determine whether a measure (referred to as the “concerned measure”) is a *digital services tax or relevant similar measure*. This request can be initiated by the Party that has enacted or is considering the measure (the “enacting Party”) or by another Party. In the latter case, a request can only be introduced when the measure is in force.

2761. The request must be sent in writing to the Depository, who is required under paragraph 2 to notify all Parties within one month.

2762. Paragraph 3 provides that the Conference of the Parties should endeavour to reach a decision within one year from the date of the notification of the request to the Parties pursuant to paragraph 2. This is an overarching deadline that is equal to the sum of the deadlines provided under the following paragraphs for each step of the procedure. The fact that one step may take more or less time than it is allotted does not, however, increase or decrease the amount of time provided by the MLC for the subsequent steps.

2763. Additionally, paragraph 3 requires the Depository to promptly issue a public notice of the decision when it is taken. The function of this public notice is to inform all concerned stakeholders, considering in particular the consequences for the allocation of Amount A Profit.

2764. Under paragraph 4, following the notification of the request to all Parties pursuant to paragraph 2, the enacting Party has four months to prepare a self-assessment and submit it to the Depository. This self-assessment should give the view of the enacting Party on whether it meets each of the criteria of the definition under Article 39(2), or whether it is covered by one of the exclusions under Article 39(3), and should be supplemented by relevant information on the measure and its impact. The self-assessment prepared by the enacting Party must be communicated promptly by the Depository to the Parties.

2765. Under paragraph 5, a meeting of the Conference of the Parties is then convened to decide upon the concerned measure. The meeting must be convened within two months from the date of the reception of the self-assessment.

2766. Paragraph 6 provides that at this meeting, the Conference of the Parties are invited to discuss the concerned measure and determine whether it is a “digital services tax or relevant similar measure” as defined in Article 39(2). Decisions of the Conference of the Parties relating to such a determination are taken by *consensus*, minus the requesting Party and, in case it is different from the latter, the enacting Party. In other words, the requesting Party, and, in the case of paragraph 1(b), the enacting Party, cannot block the decision of the Conference of the Parties relating to the determination of whether the concerned measure is a “digital services tax or relevant similar measure” as defined in Article 39(2). For the Conference of the Parties to reach a decision at this stage, there must be a *consensus* among all the other Parties on whether the measure meets the definition or not.

2767. If the Conference of the Parties is unable to reach a decision by *consensus* as described in paragraph 6, and if requested to do so by the requesting Party (or, in case the request has been introduced by the enacting Party, by a Party that considers the measure to be a *digital services tax or a relevant similar measure*), then under paragraph 7 the Conference of the Parties must establish an *ad hoc* advisory panel to examine the concerned measure and submit an analysis and a recommended determination, supported by a simple majority of panel members, to the Conference of the Parties.

2768. Paragraph 8 specifies the composition of the *ad hoc* advisory panel. It includes a representative of the Party with the concerned measure, as well as a representative of a Party who considers that the measure is a *digital services tax or relevant similar measure*, or in the case of paragraph 1(b), of the requesting Party. It also includes five other members to be designated from among the representatives of the other Parties, on the basis of a proposal by the Chair of the Conference of the Parties adopted by *consensus*. Rules on the composition of the *ad hoc* advisory panel are provided to ensure adequate representation in terms of geography and levels of development. In case the first proposal of the Chair is not adopted by *consensus*, the Chair would submit other proposals until one of them gets a *consensus*, within the timeline set by paragraph 7.

2769. Paragraph 9 sets a deadline of two months after the date of the reception of the analysis of the concerned measure and the recommendation for the Conference of the Parties to meet in order to reach a decision on the panel recommendation. The panel's recommended determination will be adopted by the Conference of the Parties unless a simple majority of the Parties to the Convention adopts the opposite determination at the meeting. For example, if the panel's recommendation is that a measure does not meet the definition, but a majority of the Parties votes to adopt the opposite determination, the Conference is considered to have decided that the measure is a *digital services tax or relevant similar measure*.

2770. Paragraph 10 defines the timing of application of the denial of Amount A in case a measure is found to be a *digital services tax or relevant similar measure*. Subparagraph (a) defines two cases where the denial of Amount A is only prospective (i.e. from the date of the decision): when the measure, although it has not been listed in Annex A, was already in effect at the date when the Convention is open to signature; when the enacting Party has requested itself a decision from the Conference of the Parties and has introduced this request at least one year before the entry into effect of the measure, thus leaving enough time for the Conference to reach a decision.

2771. In other cases, Amount A would be denied retroactively, for every period when the measure was in force and in effect, up to three calendar years before the date of the decision of the Conference. However, the Conference of the Parties has the ability to decide, based on the impact of the measure and all relevant facts and circumstances, that the denial of Amount A will be only from the date of its decision. This ability is meant to cover cases when the retroactive denial of Amount A would have disproportionate consequences compared to the impact of the measure, taking also into account the extent to which Group Entities of Covered Groups are affected by it. The relevant facts and circumstances are objective, and it is not expected that the Conference of the Parties assesses the intent of the enacting Party. Decisions on this aspect would be taken according to the same process as the decisions on whether the measure meets the definition, pursuant to paragraphs 6 through 9.

2772. Finally, paragraph 10 allows *relieving jurisdictions* to recover double tax relief provided to a *relief entity* in that Party in relation to Amount A Profit that has been retroactively eliminated. The modalities and limitations to this ability are to be defined under domestic law.

Paragraphs 11 through 14

2773. Paragraphs 11 through 14 define specific rules regarding the review of measures enacted by a *subnational entity* of a Party. Paragraph 11 provides that these measures shall be reviewed according to the rules defined by paragraphs 1 through 9. This means the Conference of the Parties will be invited to decide whether they meet the definition of *digital services taxes and relevant similar measures by consensus* (minus the requesting Party and, if different, the enacting Party); in case it does not reach a *consensus*, the provisions of paragraphs 7 through 9 on the constitution of an *ad hoc* advisory panel, the adoption of a recommendation by this panel and the decision of the Conference of the Parties on the basis of this recommendation would also be applicable. Throughout this process, the “enacting Party” is the Party in which the *subnational entity* is located. The *subnational entity* thus does not have formal standing under the process, but the enacting Party would be entitled, for example, if it chose, to invite a representative of the *subnational entity* to participate as a member of the Party’s delegation to the Conference of the Parties in order to provide an analysis of the measure.

2774. As described by paragraph 12, a *subnational entity* means any municipal, regional, or federated state or district of a Party that exercises autonomy in legislating any tax measures for a specified area. A Jurisdiction covered by means of a declaration of territorial application as per Article 42(1) is not a *subnational entity*. Paragraph 13 defines a *subnational digital services tax or relevant similar measure* as a measure enacted by a *subnational entity*, that meets all the criteria of the definition of *digital services taxes and relevant similar measures* and is not covered by any of the exclusions.

2775. When the Conference of the Parties decides a measure is a *subnational digital services tax or relevant similar measure*, there is no denial of Amount A for the Party in which the *subnational entity* is located. However, the Party will have to report in detail to the Conference of the Parties on its best efforts to achieve the removal of the measure, within six months from the decision of the Conference of the Parties. As noted in the Preamble, the efforts that can be expected from a Party are subject to the norms of its constitutional order. Both the decision of the Conference of the Parties and the report from the Party will be published within one month from the date the report is received.