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December 9, 2023

United States Treasury Department
Office of Tax Policy
By email: OTP_Pillar1MLC@treasury.gov

Re: Comments on draft OECD/G20 Inclusive Framework Multilateral Convention to Implement Amount A of Pillar One ("Pillar One MLC")

Dear Sir or Madam,

The American Petroleum Institute ("API") is the national trade association representing America's oil and natural gas industry. Our industry supports more than 11 million U.S. jobs and accounts for approximately 8 percent of U.S. GDP. API's nearly 600 members, from fully integrated oil and natural gas companies to independent companies, comprise all segments of the industry. API's members are producers, refiners, suppliers, retailers, pipeline operators, and marine transporters as well as service and supply companies providing much of our nation's energy. API was formed in 1919 as a standards setting organization and is the global leader convening subject matter experts from across the industry to establish, maintain, and distribute consensus standards for the oil and natural gas industry. API has developed more than 800 standards to enhance operational safety, environmental protection, and sustainability in the industry.

On behalf of our member companies, we submit this letter in response to the Treasury Department's request for public input on the draft Pillar One MLC. Our members wish to ensure that the final rules and relevant guidance accomplish the intent of the Inclusive Framework and provide efficient ways to ensure its goals are achieved. We submit these comments to the Department of the Treasury and Internal Revenue Service ("Treasury and IRS") in an effort to assist in developing those goals.

Our comments will focus mainly on Annex C, Section 3 of the draft Pillar One MLC, which contains provisions for the Extractives Exclusion from the Amount A regime. At the outset, however, we wish to comment on the question of whether implementation of the draft Pillar One MLC would help to bring more stability and certainty to the international taxation of multinational businesses.

Implementation of the Pillar One MLC would not enhance stability or certainty

We do not believe that implementation of the Pillar One MLC would bring added stability to the tax system for multinational businesses. The Amount A rules involve radical departures from well-established tax rules such as single-entity taxation, arm's length pricing, and the permanent establishment standard for tax jurisdiction. The formula for computing Amount A allocations is not supported by empirical evidence or a cogent economic analysis. Rather, the formula and the rest of the Amount A framework were the result of a political negotiation that occurred at a particular point in time. Notably, the agreement to use formulary apportionment was in direct conflict with the longstanding and unanimous position of the OECD countries against the use of formulary apportionment for international income taxation.

The most influential governments in the Inclusive Framework had certain policy goals in the lead-up to the political agreement embodied in the October 2021 Statement on the Two-Pillar Solution. However, those underlying policy goals

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are not shared by all constituencies in the various Inclusive Framework countries, and it is inevitable that, over time, political power in any given country will shift to a group that was not in control of the government in 2021. Thus, with the passage of time, there would be increasing pressure for changes in the Amount A rules.

Regarding certainty, we believe that the adoption of complex new tax rules such as those in the draft Pillar One MLC would create more uncertainty for both taxpayers and tax administrations. This is especially true where the new rules are not grounded in agreed policy principles or supported by a clear rationale. The provisions for dispute prevention and dispute resolution in the draft Pillar One MLC are novel and complex in themselves, so one cannot be confident that those provisions would be effective in practice. It seems more likely that implementing the Pillar One MLC, including its provisions for dispute prevention and resolution, would result in greater uncertainty and a much greater number of tax disputes and cases of unresolved double taxation.

We now turn to aspects of the draft Pillar One MLC that are specific to our industry sector, i.e., extractives.

The extractives exclusion in the draft Pillar One MLC is too narrow

We do not believe that there is any policy justification for including within the scope of Pillar One, Amount A any part of a multinational enterprise ("MNE") that derives substantially all of its profits from activities in the extractives value chain. The Inclusive Framework said in October 2020 that extractives are an industry sector "where the policy challenges of the digitalized economy do not present themselves." (Report on the Pillar One Blueprint, para. 35)

Pillar One, Amount A is intended to address perceived misallocations of the profits of MNEs among different jurisdictions due to the use of new business models that rely on intangible assets, the gathering and analysis of data from customers and others in market jurisdictions, and the ability to create scale without mass in a multinational business. **Our members' business models do not have any of these characteristics.**

The draft Pillar One MLC would limit the exclusion for extractive businesses to the upstream portion of the value chain of an extractives MNE, plus certain qualifying transportation and processing activities. We maintain that the midstream and downstream operations of extractives MNEs, like the upstream operations, have nothing in common with business models that rely on market-based intangibles and user/customer data without the need for any physical presence in the market. These operations have little to no intangible-driven value. The commodity products created from these operations are broadly traded with a great deal of transparency on pricing, which is vastly different from most non-extractive businesses, where hard-to-value intangibles are the core transfer pricing challenge.

Further, the refining process is unlike other manufacturing. The refining process can be best understood as a method of separation, which involves simply breaking down the extractive base products, such as crude oil, into their constituent parts or breaking heavy hydrocarbon molecules into lighter fuel hydrocarbons through crackers at refineries. This stands in contrast to other manufacturing processes which involve the combination of different components from different sources to produce finished products.

For these reasons, the extractives exclusion from Pillar One, Amount A should be very simple in the case of oil and gas MNEs: namely, the exclusion should cover all revenue and profits from the sale of processed and refined products derived from unprocessed natural gas and crude oil, including but not limited to, gasoline, diesel fuel, kerosene asphalt and road oil, petrochemicals, feedstocks, and lubricants.

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Significant and unnecessary administrative burden

The draft Pillar One MLC contains a complex set of Amount A rules, and a further set of complex rules (in Annex C, Section 3) which would provide a limited exclusion for Qualifying Extractives Groups. This would create a significant administrative burden for both taxpayers and tax administrations. Given the lack of a policy reason for applying the Amount A rules to any part of an extractive MNE, it makes no sense to create a complicated set of rules for a partial exclusion. Complicated new rules would inevitably lead to disputes about how to interpret the rules and apply them in practice. Where there is a compelling rationale for a new set of rules, the ensuing compliance burden needs to be borne, but in the absence of such a rationale, a heavy new compliance burden should not be imposed.

With respect to certainty concerns, we note with approval that the draft Pillar One MLC provides Covered Groups with the opportunity to supply documentation to prove that Extractives Income is out of scope. We would appreciate, however, additional clarity regarding the circumstances in which Non-Extractives Income is out of scope.

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If, however, the Inclusive Framework retains the narrow exclusion in the Pillar One MLC, it should adopt the following recommendations in order to make the rules for the extractives exclusion more workable.

Need for overall simplification

The draft rules would in effect require a Qualifying Extractives Group to analyze all of its Disclosed Segments with respect to both revenue and profitability regarding both extractive operations and non-extractive operations. Given the integrated nature of large international oil and gas groups, most Disclosed Segments are mixed segments, which would be the most difficult and time-consuming to analyze.

We propose that the exclusion for Qualifying Extractives Groups be simplified by using a one-step analysis that would distinguish between the Group's extractives revenue and profits (which are excluded from the Amount A rules) and the Group's non-extractives revenue and profits, without reference to Disclosed Segments. In other words, the MNE should take out Extractives Revenues and profits, no matter what Disclosed Segment they are in, and then test the remainder under the Amount A scope provisions. The changes proposed in the comments below should be included in the simplified, groupwide analysis.

Requirement of residence in the Jurisdiction of Extraction

The definition of Extractives Revenue requires the entity or branch earning the revenue to be resident in the Jurisdiction of Extraction. This disregards the reality of how integrated oil and gas companies conduct their business and record their revenue. For these companies, "Extractives Activity" often includes transporting products from the jurisdiction of extraction to another jurisdiction for "Qualifying Processing" of the products. Yet the revenue from these activities is not Extractives Revenue as defined. This is not consistent with the way integrated multinationals operate or with the intent of the definitions of "Qualifying Transportation," "the sale of an Extractive Product" and "Qualifying Processing." Therefore, the "Extractives Revenue" definition should be changed so as to remove the requirement of residence in the Jurisdiction of Extraction.

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We note that transitional relief from this nexus requirement for a six-year period has been included in the draft Pillar One MLC. While we welcome such relief, we believe that a permanent change would be appropriate for the reasons given above.

Scope rules: LNG processing groups

The rules in the draft Pillar One MLC include LNG processing in the definition of Qualifying Processing, which in turn is included in the definition of Extractives Activity, the revenue from which is Extractives Revenue (subject to the residence requirement noted above). However, an LNG processing group cannot be a Qualifying Extractives Group unless it conducts Exploration, Development, or Extraction as those terms are defined in the rules. Thus, an LNG processing group that processes natural gas purchased from unrelated parties would not be able to benefit from the Extractives Exclusion from Amount A. Given the policy basis for the Amount A rules and for the Extractives Exclusion, this result does not make sense.

We propose that the requirement to conduct Exploration, Development, or Extraction be deleted, so that Extractives Revenue will be within the scope of the Extractives Exclusion in all cases, which is completely consistent with policy considerations.

Scope Rules: carbon capture

The rules limit the coverage of carbon capture to situations where carbon is captured and used to remove more Extractive Products from the earth. The definition of Extractives Revenue needs to include revenues from the full life cycle, and the coverage of carbon capture needs to be expanded to include storing carbon even when it is not associated with removing more Extractive Products.

Scope Rules: Joint Ventures

Joint Ventures that are not included in an extractives group's consolidated financial statements should be excluded from the definition of Qualifying Extractives Group. Including joint ventures will cause complications when not all parties to the joint venture are in scope of the Pillar One, Amount A rules and may require the parties to change their joint venture agreements.

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Comments on the draft Pillar One MLC, not specific to the Extractives Exclusion

- The draft Amount A allocation rules appear to accept the idea of some double counting of an MNE group's residual profits in a market jurisdiction, due to the way the Marketing and Distribution Profits Safe Harbour (MDSH) has been designed. This undermines the purpose of the MDSH and the Amount A rules more broadly. We recommend modification of the design of the MDSH in order to ensure that double taxation of residual profits in market jurisdictions does not occur.

- The position of Brazil, Colombia, and India regarding how withholding taxes should be taken into account in computing the MDSH and the elimination of double taxation for Amount A purposes is unacceptable as it would result in double taxation.

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- The revenue sourcing rules in the draft Pillar One MLC would impose an unrealistic compliance burden on taxpayers. Extractive MNEs typically sell to unrelated distributors that are unlikely to be within the scope of Amount A. These distributors have no reason to trace sales through to the final customers, and they cannot be compelled to do so because the sharing of information on final customers will run afoul of competition laws in some countries. Thus, the sourcing rule is impractical, as the extractive MNEs would be unable to trace sales through to the final customers. Petrochemicals and refining by-products are components that are even more difficult to trace as they end up in a vast array of consumer goods manufactured by large numbers of separate companies. The fallback rules providing for the use of allocation keys are not satisfactory solutions to the sourcing problem, as those allocation keys are essentially arbitrary as applied to any particular group's revenues.

We appreciate the opportunity to comment on the draft Pillar One MLC and look forward to continued interaction as this process moves forward. To the extent you have any questions, please do not hesitate to contact me at colgana@api.org or 202-682-8044.

Sincerely,

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