



December 11, 2023

Michael Plowgian
Deputy Assistant Secretary (International Tax Affairs)
U.S. Department of Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Via E-Mail: OTP_Pillar1MLC@treasury.gov

Re: Comments in Response to Treasury’s Request for Public Input on Draft OECD/G20 Inclusive Framework Pillar One Multilateral Convention Text

Dear Deputy Assistant Secretary Plowgian:

Microsoft Corporation (“Microsoft”) appreciates the opportunity to respond to Treasury’s request for comments on the Draft OECD/G20 Inclusive Framework Pillar One Multilateral Convention Text (“Pillar One MLC”).

We commend Treasury for its ongoing efforts to develop an internationally agreed net-income based approach and to seek public input “to ensure transparency, to facilitate the resolution of several remaining open issues, and to hear whether the proposed framework would be workable for U.S. taxpayers and other stakeholders.” We appreciate that Treasury is “especially interested in comments related to novel issues identified by a review of the complete text, implementation and administrability issues (including the balance between simplification and technical precision), and technical adjustments to address errors or clarify the operation of the Pillar One MLC provisions.”

While it will be important for Treasury to continue its efforts and to resolve numerous open issues, we question whether the Pillar One MLC will be administrable both for the IRS and other tax administrations and workable for taxpayers due to complexity resulting from political negotiations among the parties. In some cases, the novel, negotiated outcomes will be difficult to apply and appear likely to lead to protracted disputes among countries and between countries and taxpayers.

Introduction. Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. We are creating the platforms and tools, powered by artificial intelligence (“AI”), that deliver better, faster, and more effective solutions to support small and large business competitiveness, improve educational and health outcomes, grow public-sector efficiency, and empower human ingenuity. From infrastructure and data to business applications and collaboration, we provide unique, differentiated value to customers.

Magnitude - OECD Economic Impact Assessment of Pillar One. On October 11, the OECD released an update to its economic impact assessment of Pillar One which estimated “the total amount of allocable residual profit under Amount A is USD 204.6 billion of residual profit, coming from 106 MNEs.”¹ The OECD impact assessment does not reference the amount of residual profits from U.S. MNEs, but some academics estimate approximately sixty percent of residual profits to be reallocated under Amount A will be from U.S. MNEs. If that is the case, Amount A would reallocate over USD 120 billion per year from U.S. MNEs, and these figures are likely to increase. As such, a clear understanding of the outcomes the Pillar One MLC would deliver will be particularly important to the U.S. government.

Comments. While we support efforts to negotiate a net-income based agreement that is administrable for tax administrations and workable for taxpayers, we are concerned that the current draft is not administrable or workable and believe further negotiations are necessary to resolve the political and technical issues outlined below.

1. **Revenue Sourcing.** Rather than apply longstanding financial accounting revenue sourcing rules, the draft MLC requires in scope businesses to characterize their revenue into multiple categories and source it by looking through their distributors, resellers, and customers to the jurisdiction of the final customer for goods and the end user for services via various novel indicators. If this is not possible, various allocation keys (including an allocation key based on Gross Domestic Product) are used which may disadvantage the U.S. by arbitrarily sourcing revenue from U.S. businesses to jurisdictions with little or no relation to the actual business. Application of these novel revenue sourcing rules will be subject to a multi-year dispute resolution process.
2. **Marketing and Distribution Safe Harbor (MDSH) and Partial Inclusion of Withholding Taxes (“WHT”).** The MDSH was intended to cap the allocation of Amount A to market jurisdictions that already impose tax on a group’s residual profits. The MDSH accounts for WHT imposed by market jurisdictions, recognizing that these taxes enable market jurisdictions to tax a group’s residual profit. While we commend the negotiators for taking WHT into account, as drafted, the following limitations prevent the MDSH from achieving its objective of preventing double counting:
 - a. A de minimis rule limits the application of the MDSH to jurisdictions where a taxpayer already has more than EUR 50 million in profits before tax. This materially and arbitrarily limits the number of jurisdictions where the MDSH applies and stands in stark contrast to the nexus threshold which is set at between EUR 250k and EUR 1 million.
 - b. The profit already taxed in a market jurisdiction through WHT is not fully considered because of a “reduction factor” that reduces this adjustment. For a two-year transition period this reduction factor is set to 100%, meaning that WHT is not accounted for at all in the MDSH. This rate falls to between 50% to 75% for a further five-years, and in jurisdictions where groups suffer WHT but

¹ O’Reilly, P., et al. (2023), “Update to the economic impact assessment of pillar one: OECD/G20 Base Erosion and Profit Shifting Project”, *OECD Taxation Working Papers*, No. 66, OECD Publishing, Paris, <https://doi.org/10.1787/7c35a55c-en> (para 27 and 28).

have no physical operations remains at 60% in perpetuity. There is no policy rationale to support this reduction factor.

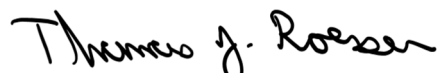
- c. When calculating the excess profit threshold for purposes of determining residual profits already taxed by a jurisdiction, the draft Pillar One MLC arbitrarily sets the threshold at the higher of a 3% return on revenue or a so-called "normal return" on jurisdictional depreciation and payroll.
 - d. After total excess profit is calculated, an offset percentage (between 25% and 90%) limits the proportion of excess profits that will be available to offset against Amount A.
3. **Identification of Jurisdictions Required to Eliminate Double Taxation.** Instead of requiring relieving entities in jurisdictions to have a connection to the market, the draft Pillar One MLC identifies the jurisdiction required to provide relief from double taxation via a tiering mechanism based on a comparison to group return on depreciation and payroll. This results in jurisdictions that may have no connection to the market being required to provide relief in respect of that market.
 4. **Provision for Relief for Amount A.** The draft Pillar One MLC provides countries with flexibility under their domestic law to provide relief via deductions or credits. This flexibility could result in a relieving jurisdiction deferring relief until a determination panel provides a result. This could take several years with U.S. taxpayers being subject to paying multiple years of regular and Amount A taxes and carrying the float until relief, if any, is eventually provided.
 5. **Administration.** The complexity of Pillar One will make it challenging for taxpayers, the IRS and other tax administrations to apply and administer. For taxpayers, the revenue-sourcing rules create significant additional reporting requirements. For the IRS and other tax administrations, the new rules impose significant additional administrative requirements, from information exchange to participation in numerous multilateral review panels. The MLC does not provide details on the Amount A Tax Return or Common Documentation Package that taxpayers would be required to file. Therefore, it is not possible to comment on this aspect of Pillar One.
 6. **Tax Certainty Framework for Amount A.** The tax certainty framework for Amount A only seeks to provide after-the-fact certainty. This will result in taxpayers facing up to five years of unrelieved double taxation because they will be required to pay the Amount A tax on the reallocated profits. Because any jurisdiction can object to the decision reached by the first step of the tax certainty process (the Review Panel), many disputes will need to be resolved by the second step (the Determination Panel). The seven-person Determination Panel (comprised of three government officials, three non-government independent experts, and a chair who may be an independent expert) which will determine the jurisdictions that are allocated additional taxing rights and those that are required to relieve double taxation. Once non-government independent experts are approved to be part of the pool of experts, there is no government oversight mechanism over them, and it is very difficult to remove an independent expert from the pool of experts (let alone a panel).

7. **Removal of Digital Services Taxes (“DSTs”) and Relevant Similar Measures (“RSMs”).** The Pillar One MLC seems to provide jurisdictions with the option of applying Amount A or a DST or RSM. If a jurisdiction were to introduce a DST, the only consequence is that they are not able to tax the profits that would otherwise be allocated to them under Amount A. This may encourage jurisdictions to adopt a DST if they are unhappy with the tax revenue raised through Pillar One or the administrative burden associated with those revenues.
8. **Amount B.** The draft Pillar One MLC does not include Amount B. Pillar One was intended to operate as a package with Amount A reallocating a portion of non-routine profits to market jurisdictions and Amount B simplifying transfer pricing rules for in-country baseline marketing and distribution activities in a way that is consistent with the arm’s length principle. This recognizes that Amount B is integral to achieving Pillar One’s goal of stabilizing the international tax architecture. As such, we believe that groups subject to the Amount A rules should be eligible for Amount B for all their in-country baseline marketing and distribution activities, including the distribution of all types of goods and services, such as software and cloud services.
9. **Interaction between Amount A and Pillar Two.** We understand that Amount A is ordered before Pillar Two, but additional clarity is required regarding where the Amount A taxes incurred in market jurisdictions will be accounted for under Pillar Two.
10. **Lack of Clarity regarding Required Funding and Resources for Tax Administrations and OECD Secretariat.** There is a lack of clarity whether the U.S. and other countries are committed to funding and providing resources to their tax administrations and the OECD Secretariat given their significantly increased roles and responsibilities that will be required if the draft Pillar One MLC is implemented.

Finally, additional clarity is required to ensure that any additional tax paid by a U.S. MNE due to Amount A is eligible for a U.S. foreign tax credit to minimize double taxation.

As noted above, we remain concerned about the administrability and workability of the current version of the draft Pillar One MLC for the IRS, other tax administrations and U.S. taxpayers. We appreciate the opportunity to provide comments and encourage Treasury to continue its negotiations.

Sincerely,



Thomas J. Roesser
Tax Policy Counsel