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TaxNewsFlash

Canada

OECD Asks for More Feedback on Pillar One and Two Specifics

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Large multinational enterprises (MNEs) may want to follow the Organization for Economic Cooperation and Development (OECD)'s latest consultations on its two-pillar approach to address tax challenges arising from the digitalization of the economy. The OECD has now released new consultation papers as part of its proposals to ensure that certain MNEs pay tax in countries where they have consumer-facing activities but do not have a physical presence, and to introduce a global minimum tax. Specifically, the OECD is asking for public feedback on draft provisions to eliminate existing digital services taxes (DSTs) and similar measures under Pillar One, as well as on certain implementation aspects of the global anti-base erosion (GloBE) rules under Pillar Two. As part of its package on Pillar Two, the OECD has also released guidance on safe harbours and penalty relief.

The OECD's release of these consultation documents is the latest in a series of planned public consultations to consider different elements of its two-pillar proposal.

Background
The OECD first released details of the proposals under review to address challenges of tax and the digital economy in 2019 as part of its base erosion and profit shifting (BEPS) project. Generally, the OECD/G20 Inclusive Framework contemplates tax proposals under two specific "pillars".

Pillar One focuses on the allocation of taxing rights, including nexus issues. Specifically, the OECD's Pillar One proposal introduces a new mechanism for allocating profit, which applies to MNEs with global revenue above €20 billion and profit before tax exceeding 10%, with 25% of adjusted profit before tax in excess of the 10% (i.e., Amount A) to be reallocated to market jurisdictions. A market jurisdiction will be eligible to tax Amount A if the “Covered Group” derives more than EUR 1 million in revenues from that jurisdiction, or, alternatively, EUR 250,000 if that jurisdiction’s GDP is lower than EUR 40 billion. Extractives and regulated financial services that meet defined criteria are excluded from the scope of these rules. In addition, Pillar One also outlines a proposed approach to mandatory binding dispute prevention and resolution for Amount A. Pillar One also contemplates simplifying the application of the arm’s length principle to in-country baseline marketing and distribution activities (Amount B), which would have a broader scope and would not be subject to the revenue and profitability thresholds applicable to Amount A. For details, see *TaxNewsNow*, “OECD Pillar One Work Continues with New Amount B Consultation”.

Pillar Two focuses on ensuring certain MNEs pay a minimum rate of tax. As part of this pillar, the OECD/G20 Inclusive Framework released model global minimum tax rules in December 2021, followed by commentary and examples in March 2022. The release of the model rules and related commentary followed the agreement of over 135 countries, including Canada, on several key aspects of the two-pillar framework, in a statement on October 8, 2021. Under these rules, MNEs with revenue above €750 million will be subject to a minimum 15% tax rate under Pillar Two.

For details, see *TaxNewsFlash-Canada* 2022-12, “OECD Offers Guidance on Global Minimum Tax Rules”, *TaxNewsFlash-Canada* 2021-63, “OECD Releases Model Global Minimum Tax Rules”, *TaxNewsFlash-Canada* 2021-48, “OECD Clarifies Global Minimum Tax Plan for 2023” and *TaxNewsFlash-Canada* 2021-47, “OECD Moves Forward with 15% Global Minimum Tax for 2023”.

Pillar One consultation

Digital services taxes

The OECD is asking for public feedback on specific draft provisions of a multilateral convention that would, among other changes to help implement Pillar One, require countries to remove all existing DSTs and other similar measures and prevent countries from adopting equivalent measures in the future. The OECD will accept comments on these draft provisions of the proposed multilateral convention until January 20, 2023.

For further details on the Pillar One consultation, see a *TaxNewsFlash* by the KPMG member firm in the U.S.

KPMG observations
Canada previously indicated that it would move ahead, no earlier than January 1, 2024, with draft legislation to introduce a 3% DST retroactive on applicable revenues earned as of January 1, 2022 if the multilateral convention implementing Pillar One has not come into force. Finance released draft legislation for the *Digital Services Tax Act* on December 14, 2021 that includes rules to compute and impose the DST (see

TaxNewsFlash-Canada 2021-64, "Canada Lays Out Digital Tax Proposals for Businesses").

Pillar Two consultation

The OECD released a Pillar Two implementation package that includes guidance on safe harbours and penalty relief, as well as two consultation documents related to the GloBE information return and tax certainty. The OECD will accept comments on these consultation documents until February 3, 2023.

The OECD also advises that it will issue administrative guidance on the interpretation or administration of the global minimum tax on a rolling basis, with the first package of administrative guidance expected in early 2023.

Safe harbour and penalty relief guidance

The OECD's implementation package notes that Pillar Two includes safe harbours and penalty relief that are designed to minimize the compliance burden associated with undertaking the full GloBE effective tax rate calculation for "lower risk jurisdictions". The relief guidance includes a transitional country-by-country (CbC) reporting safe harbor that has already been agreed by the Inclusive Framework and a framework for the development of a potential permanent safe harbor. In addition, a transitional penalty relief regime may apply when an MNE has taken "reasonable measures" to correctly apply the GloBE rules.

GloBE information return

The OECD release includes a public consultation document on the GloBE information return. As part of this consultation, the OECD is seeking public input on the data requirements associated with complying with the GloBE rules, the exchange of the information return and other related issues.

Tax certainty for the GloBE rules

The OECD release also seeks input on achieving tax certainty for the GloBE rules through various mechanisms, including dispute prevention and resolution.

For further details on the Pillar Two implementation package, see a report by the KPMG member firm in the U.S. that provides observations and analysis of the implementation package.

KPMG observations
Canadian MNEs should prepare for Pillar Two adoption in Canada, including to consider how the GloBE information return could add another layer to Canada's comprehensive international tax reporting requirements. Finance recently reiterated its continued commitment to implement Pillar Two, while other countries have already taken action to

begin the implementation process. In particular, the EU agreed to adopt the Pillar Two directive into member states' domestic law by December 31, 2023.

We can help

Your KPMG adviser can help you assess the effect of the OECD's proposals on your business and provide guidance on how this might affect you in the future.

For more information, contact your KPMG adviser, or one of the following tax professionals:

Demet Tepe
National Leader Transfer Pricing
T: 514-840-5767
E: dtepe@kpmg.ca

Walter Sisti
National Leader Indirect Tax Services
T: 416-777-3920
E: wsisti@kpmg.ca

Sharon Szeto
Partner, International Corporate Tax
T: 416-777-3231
E: sszeto@kpmg.ca