



China Tax Alert

Issue 4, January 2019

OECD outlines work on future of international tax rules

Regulations discussed in this issue:

- Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note ('Policy Note'), approved by the Inclusive Framework on BEPS (IF) on 23 January 2019 and released on the OECD website on 29 January 2019.
- Interim Report on the Tax Challenges Arising from Digitalisation, prepared by the Task Force on the Digital Economy (TFDE), and released on the OECD website on 16 March 2018 (TFDE Interim Report).
- BEPS Action 1 Report "Addressing the Tax Challenges of the Digital Economy", prepared by the TFDE, released by the OECD on 5 October 2015.

Background

On 29 January 2019, the OECD Centre for Tax Policy and Administration (CTPA) hosted an OECD Tax Talk, and released a Policy Note, setting out significant new detail on work plans to address the tax challenges arising from the digitalisation of the economy (DoE), and to resolve remaining Base Erosion and Profit Shifting (BEPS) issues, still outstanding from earlier OECD work. A March 2019 public consultation was announced, feedback from which will inform a detailed work plan to be agreed by the G20 Finance Ministers in June 2019.

The proposals being put forward could have an impact on all businesses, going well beyond the highly digitalised 'platform' business models on which so much attention has focused in recent years. New rules would apply in place of well-worn international tax rules, from physical presence permanent establishment (PE) to the traditional transfer pricing (TP) arm's length principle (ALP), for in-scope enterprises. In view of the 18 months set between the June 2019 G20 meeting and the end-2020 completion date the OECD CTPA Director, Pascal Saint-Amans, observed that the task is bigger than the BEPS project, and with less time. Businesses operating in China, both outbound and inbound, would be well advised to monitor these developments and consider participation in the upcoming consultation.

Addressing digitalisation and remaining BEPS issues

Work at G20/OECD level on DoE tax issues has been ongoing since 2013, resulting in the 2015 BEPS Action 1 report and the March 2018 TFDE Interim Report; see [China Tax Alert Issue 8 of 2018](#). That report saw no consensus on a solution, but countries committed to explore changing nexus and profit allocation rules; this has now produced several proposals.

Four proposals have been put forward, and are grouped under two “pillars”. The three proposals under the first pillar look at changing the fundamental balance of international tax rules, allocating more of multinational enterprise (MNE) profits to the countries of markets or online users. These were described on the Tax Talk as being:

- User value creation approach: Originally put forward by the UK, this asserts that active user data and participation makes a significant contribution to profits for online advertising and gig economy businesses. Foreign enterprises could be treated as having a taxable presence in the user country, even without having a physical PE or subsidiary. A special new profit split, going beyond the TP ALP, could be used to attribute part of the MNE’s global residual profits (i.e. after remunerating the routine functions of MNE group entities) to the user country.
- Marketing intangibles approach: Proposed by the US, this would go broader than the above. Foreign enterprises whose businesses are highly reliant on marketing intangibles could be treated as having a taxable presence in a market country, on the basis of a new assertion that their marketing intangibles are “located there”. A new, non-ALP residual profits split would then allocate the part of global residual profits, attributable to marketing intangibles, into the market.
- Significant economic presence (SEP) approach: Advocated by India and Colombia, this would develop the BEPS Action 1 Report SEP (i.e. ‘virtual PE’) idea with a simplified profit allocation rule that would be easier for emerging economy tax authorities to apply.

Pillar 2 sets out a minimum tax rule, put forward by Germany and France, which would allow countries to ‘tax back’ profits of an MNE which have been ‘shifted’ into low tax countries. This would involve a special residence country CFC-style rule, drawing on the new US Global Intangible Low Taxed Income (GILTI) rule, as well as a source country base erosion rule, which could deny tax deductions on payments to countries where ‘low’ tax would apply. The coordination mechanism, the ‘minimum rate’, and other detail would need to be agreed.

KPMG observations

Work would proceed on these rules on a ‘without prejudice’ basis, meaning that countries would not be committed to particular outcomes. Nonetheless, it is clear that major changes are on the horizon. For businesses operating in China, whether with outbound or inbound operations, and whether being highly digitalised or more traditional, the rules emerging could have a profound impact on their global effective tax rates, their internal record keeping and tax risk management systems, their corporate structures, and their market competitiveness. A full consultation paper is set to be released by 12 February allowing three weeks for comments before the 13 March public consultation. Given the profound changes under consideration, businesses with a China connection are urged to study the document in detail, and raise concerns and issues for factoring into the work to 2020. Further KPMG updates will be released, and you can also read our recent DoE and tax article in [China Looking Ahead 2018](#).



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Contact us

National



Lewis Lu

Head of Tax
KPMG China
T: +86 (21) 2212 3421
E: lewis.lu@kpmg.com



Khoonming Ho

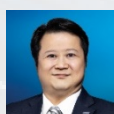
Head of Tax, KPMG Asia Pacific
Tax Partner, KPMG China
T: +86 (10) 8508 7082
E: khoonming.ho@kpmg.com



Sunny Leung

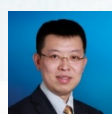
Technology, media and telecommunications
(TMT) sector tax leader
KPMG China
T: +86 (21) 2212 3488
E: sunny.leung@kpmg.com

Northern Region



Vincent Pang

Head of Tax, Northern Region
KPMG China
T: +86 (10) 8508 7516
E: vincent.pang@kpmg.com



Tony Feng

Tax Partner
KPMG China
T: +86 (10) 8508 7531
E: tony.feng@kpmg.com



Jessie Zhang

Tax Partner
KPMG China
T: +86 (10) 8508 7625
E: jessie.j.zhang@kpmg.com



Conrad Turley

Tax Partner
KPMG China
T: +86 (10) 8508 7513
E: conrad.turley@kpmg.com

Eastern and Western Region



Sunny Leung

Technology, media and telecommunications
(TMT) sector tax leader
KPMG China
T: +86 (21) 2212 3488
E: sunny.leung@kpmg.com



Mimi Wang

Tax Partner
KPMG China
T: +86 (21) 2212 3250
E: mimi.wang@kpmg.com



Benjamin Lu

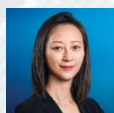
Tax Director
KPMG China
T: +86 (21) 2212 3462
E: benjamin.lu@kpmg.com



John Wang

Tax Partner
KPMG China
T: +86 (571) 2803 8088
E: john.wang@kpmg.com

Southern Region



Lilly Li

Head of Tax, Southern Region
KPMG China
T: +86 (20) 3813 8999
E: lilly.li@kpmg.com



Kelly Liao

Tax Partner
KPMG China
T: +86 (20) 3813 8668
E: kelly.liao@kpmg.com



Mabel Li

Tax Partner
KPMG China
T: +86 (755) 2547 1164
E: mabel.li@kpmg.com

Hong Kong



Alice Leung

Tax Partner
KPMG China
T: +852 2143 8711
E: alice.leung@kpmg.com

For any enquiries, please send to our public mailbox: taxenquiry@kpmg.com or contact our partners/directors in each China/HK offices.

Khoonming Ho
Head of Tax,
KPMG Asia Pacific
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Lewis Lu
Head of Tax,
KPMG China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Beijing/Shenyang/Qingdao
Vincent Pang
Tel. +86 (532) 8907 1728
vincent.pang@kpmg.com

Tianjin
Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Shanghai/Nanjing/Chengdu
Anthony Chau
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Hangzhou
John Wang
Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Guangzhou
Lilly Li
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen
Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Shenzhen
Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong
Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern Region

Vincent Pang
Head of Tax,
Northern Region
Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

Conrad TURLEY
Tel. +86 (10) 8508 7513
conrad.turley@kpmg.com

Yali Chen
Tel. +86 (10) 8508 3036
yali.chen@kpmg.com

Milano Fang
Tel. +86 (532) 8907 1724
milano.fang@kpmg.com

Tony Feng
Tel. +86 (10) 8508 7531
tony.feng@kpmg.com

Flora Fan
Tel. +86 (10) 8508 7611
flora.fan@kpmg.com

John Gu
Tel. +86 (10) 8508 7095
john.gu@kpmg.com

Rachel Guan
Tel. +86 (10) 8508 7613
rachel.guan@kpmg.com

Helen Han
Tel. +86 (10) 8508 7627
h.han@kpmg.com

Michael Wong
Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Henry Kim
Tel. +86 (10) 8508 5000
henry.kim@kpmg.com

Ruby Jiang
Tel. +86 (10) 8553 3680
ruby.jiang@kpmg.com

David Ling
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Lisa Li
Tel. +86 (10) 8508 7638
lisa.h.li@kpmg.com

Lucia Liu
Tel. +86 (10) 8508 7570
lucia.jj.liu@kpmg.com

Alan O'Connor
Tel. +86 (10) 8508 7521
alan.oconnor@kpmg.com

Shirley Shen
Tel. +86 (10) 8508 7586
yinghua.shen@kpmg.com

Joseph Tam
Tel. +86 (10) 8508 7605
laiyiu.tam@kpmg.com

Joyce Tan
Tel. +86 (10) 8508 7666
joyce.tan@kpmg.com

Christopher Xing
Tel. +86 (10) 8508 7072
christopher.xing@kpmg.com

Kensuke MATSUDA
Tel. +86 (10) 8508 7034
kensuke.matsuda@kpmg.com

Irene Yan
Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Adams Yuan
Tel. +86 (10) 8508 7596
adams.yuan@kpmg.com

Jessie Zhang
Tel. +86 (10) 8508 7625
jessie.j.zhang@kpmg.com

Sheila Zhang
Tel. +86 (10) 8508 7507
sheila.zhang@kpmg.com

Tracey Zhang
Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Vivian Zhou
Tel. +86 (10) 8508 3360
v.zhou@kpmg.com

Carol Cheng
Tel. +86 (10) 8508 7644
carol.y.cheng@kpmg.com

Ally Mi
Tel. +86 (10) 8508 7583
ally.mi@kpmg.com

Kenny Wang
Tel. +86 (10) 8508 7655
kenny.wang@kpmg.com

Fiona Yu
Tel. +86 (10) 8508 7663
fiona.yu@kpmg.com

Lily Zhang
Tel. +86 (10) 8508 7545
lily.l.zhang@kpmg.com

Eric Zhao
Tel. +86 (10) 8508 7493
eric.zhao@kpmg.com

Laura Xu
Tel. +86 (532) 8907 1731
laura.xu@kpmg.com

Eastern and Western Region

Anthony Chau
Head of Tax,
Eastern & Western Region
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Cheng Chi
Tel. +86 (21) 2212 3433
cheng.chi@kpmg.com

Johnny Deng
Tel. +86 (21) 2212 3457
johnny.deng@kpmg.com

Cheng Dong
Tel. +86 (21) 2212 3410
cheng.dong@kpmg.com

Chris Ge
Tel. +86 (21) 2212 3083
chris.ge@kpmg.com

Chris Ho
Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Henry Wong
Tel. +86 (21) 2212 3380
henry.wong@kpmg.com

Jason Jiang
Tel. +86 (21) 2212 3527
jason.jt.jiang@kpmg.com

Sunny Leung
Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Michael Li
Tel. +86 (21) 2212 3463
michael.y.li@kpmg.com

Karen Lin
Tel. +86 (21) 2212 4169
karen.w.lin@kpmg.com

Benjamin Lu
Tel. +86 (21) 2212 3462
benjamin.lu@kpmg.com

Christopher Mak
Tel. +86 (21) 2212 3409
christopher.mak@kpmg.com

Naoko Hirasawa
Tel. +86 (21) 2212 3098
naoko.hirasawa@kpmg.com

Ruqiang Pan
Tel. +86 (21) 2212 3118
ruqiang.pan@kpmg.com

Amy Rao
Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Wayne Tan
Tel. +86 (28) 8673 3915
wayne.tan@kpmg.com

Tanya Tang
Tel. +86 (25) 8691 2850
tanya.tang@kpmg.com

Rachel Tao
Tel. +86 (21) 2212 3473
rachel.tao@kpmg.com

Janet Wang
Tel. +86 (21) 2212 3302
janet.z.wang@kpmg.com

John Wang
Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Mimi Wang
Tel. +86 (21) 2212 3250
mimi.wang@kpmg.com

Jennifer Weng
Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

Grace Xie
Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Bruce Xu
Tel. +86 (21) 2212 3396
bruce.xu@kpmg.com

Jie Xu
Tel. +86 (21) 2212 3678
jie.xu@kpmg.com

Robert Xu
Tel. +86 (21) 2212 3124
robert.xu@kpmg.com

Jason Yu
Tel. +86 (21) 2212 3316
jim.yu@kpmg.com

William Zhang
Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

Hanson Zhou
Tel. +86 (21) 2212 3318
hanson.zhou@kpmg.com

Michelle Zhou
Tel. +86 (21) 2212 3458
michelle.b.zhou@kpmg.com

Eric Zhang
Tel. +86 (21) 2212 3398
eric.zhang@kpmg.com

Kevin Zhu
Tel. +86 (21) 2212 3346
kevin.x.zhu@kpmg.com

Leon Shao
Tel. +86 (21) 2212 3622
leon.shao@kpmg.com

Joyce Wang
Tel. +86 (21) 2212 3387
joyce.t.wang@kpmg.com

Robin Xiao
Tel. +86 (21) 2212 3273
robin.xiao@kpmg.com

Ellen Yan
Tel. +86 (21) 2212 3484
ellen.yan@kpmg.com

Tim Zeng
Tel. +86 (21) 2212 3759
tim.zeng@kpmg.com

Southern Region

Lilly Li
Head of Tax,
Southern Region
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Vivian Chen
Tel. +86 (755) 2547 1198
vivian.w.chen@kpmg.com

Nicole Cao
Tel. +86 (20) 3813 8619
nicole.cao@kpmg.com

Felix Feng
Tel. +86 (20) 3813 7060
felix.feng@kpmg.com

Ricky Gu
Tel. +86 (20) 3813 8620
ricky.gu@kpmg.com

Fiona He
Tel. +86 (20) 3813 8623
fiona.he@kpmg.com

Aileen Jiang
Tel. +86 (755) 2547 1163
aileen.jiang@kpmg.com

Cloris Li
Tel. +86 (20) 3813 8829
cloris.li@kpmg.com

Jean Li
Tel. +86 (755) 2547 1128
jean.j.li@kpmg.com

Sisi Li
Tel. +86 (20) 3813 8887
sisi.li@kpmg.com

Mabel Li
Tel. +86 (755) 2547 1164
mabel.li@kpmg.com

Kelly Liao
Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Patrick Lu
Tel. +86 (755) 2547 1187
patrick.c.lu@kpmg.com

Grace Luo
Tel. +86 (20) 3813 8609
grace.luo@kpmg.com

Ling Lin
Tel. +86 (755) 2547 1170
ling.lin@kpmg.com

Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Chris Xiao
Tel. +86 (20) 3813 8630
chris.xiao@kpmg.com

Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Koko Tang
Tel. +86 (755) 2547 4180
koko.tang@kpmg.com

Bin Yang
Tel. +86 (20) 3813 8605
bin.yang@kpmg.com

Lixin Zeng
Tel. +86 (20) 3813 8812
lixin.zeng@kpmg.com

Nicole Zhang
Tel. +86 (20) 3813 8644
nicole.ll.zhang@kpmg.com

Bruce Liu
Tel. +86 (20) 3813 8636
bruce.liu@kpmg.com

Sophie Lu
Tel. +86 (20) 2547 1141
ss.lu@kpmg.com

Fiona Wu
Tel. +86 (20) 3813 8606
fiona.wu@kpmg.com

Philip Xia
Tel. +86 (20) 3813 8674
philip.xia@kpmg.com

Hong Kong

Curtis Ng
Head of Tax, Hong Kong
Tel. +852 2143 8709
curtis.ng@kpmg.com

Ayesha M. Lau
Tel. +852 2826 7165
ayasha.lau@kpmg.com

Darren Bowdern
Tel. +852 2826 7166
darren.bowdern@kpmg.com

Yvette Chan
Tel. +852 2847 5108
yvette.chan@kpmg.com

Lu Chen
Tel. +852 2143 8777
lu.l.chen@kpmg.com

Patrick Cheung
Tel. +852 3927 4602
patrick.p.cheung@kpmg.com

Wade Wagatsuma
Tel. +852 2685 7806
wade.wagatsuma@kpmg.com

Natalie To
Tel. +852 2143 8509
natalie.to@kpmg.com

Elizabeth DE LA CRUZ
Tel. +852 2826 8071
elizabeth.delacruz@kpmg.com

Matthew Fenwick
Tel. +852 2143 8761
matthew.fenwick@kpmg.com

Sandy Fung
Tel. +852 2143 8821
sandy.fung@kpmg.com

Charles Kinsley
Tel. +852 2826 8070
charles.kinsley@kpmg.com

Stanley Ho
Tel. +852 2826 7296
stanley.ho@kpmg.com

Becky Wong
Tel. +852 2978 8271
becky.wong@kpmg.com

Barbara Forrest
Tel. +852 2978 8941
barbara.forrest@kpmg.com

Kate Lai
Tel. +852 2978 8942
kate.lai@kpmg.com

Travis Lee
Tel. +852 2143 8524
travis.lee@kpmg.com

Irene Lee
Tel. +852 2685 7372
irene.lee@kpmg.com

Alice Leung
Tel. +852 2143 8711
alice.leung@kpmg.com

Ivor Morris
Tel. +852 2847 5092
ivor.morris@kpmg.com

Benjamin Pong
Tel. +852 2143 8525
benjamin.pong@kpmg.com

Malcolm Prebble
Tel. +852 2684 7472
malcolm.j.prebble@kpmg.com

David Siew
Tel. +852 2143 8785
david.siew@kpmg.com

Murray Sarelius
Tel. +852 3927 5671
murraysarelius@kpmg.com

John Timpany
Tel. +852 2143 8790
john.timpany@kpmg.com

Lachlan Wolfers
Tel. +852 2685 7791
lachlan.wolfers@kpmg.com

Daniel Hui
Tel. +852 2685 7815
daniel.hui@kpmg.com

Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Adam Zhong
Tel. +852 2685 7559
adam.zhong@kpmg.com

Eva Chow
Tel. +852 2685 7454
eva.chow@kpmg.com

Alexander ZEGERS
Tel. +852 2143 8796
zegers.alexander@kpmg.com

Gabriel Ho
Tel. +852 3927 5570
gabriel.ho@kpmg.com

Vivian Tu
Tel. +852 2913 2578
vivian.l.tu@kpmg.com