

OECD consultation document details planned new international tax rules

Regulations discussed in this issue:

- Secretariat Proposal for a Unified Approach under Pillar 1 – Public Consultation Document ('Oct 2019 consultation document'), released on the OECD website on 9 October 2019.
- Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy ('programme of work'), released on the OECD website on 31 May 2019.
- Addressing the Tax Challenges of the Digitalisation of the Economy – Public Consultation Document ('Feb 2019 consultation document'), released on the OECD website on 13 February 2019.

Background

On 9 October 2019 the OECD released on their website a public consultation document on a proposed "unified approach" for the overhaul of international tax rules. Comments are due by 12 November, prior to consultation meetings on 21, 22 November.

The unified approach details a new tax nexus rule which gives countries taxing rights over foreign enterprises without any physical presence in their markets, and a new formulaic approach to profit attribution. It is an effort by the OECD Secretariat and the Steering Group (SG) of the Inclusive Framework (IF) to bridge the gap between the three proposals put forward in early 2019 by the US, UK and India, and reach global agreement by 2020. Given the impact the new rules would have on multinational enterprise (MNE) global structures, supply chains, and business models, the China business community should highlight their concerns at this stage.

The unified approach

As explained in earlier 2019 KPMG China bulletins ([China Tax Alert Issue 7](#) and [Issue 17](#)), in May and June a programme of work was fixed under which various Working Parties (WPs) would explore the technical design challenges for new nexus and profit attribution rules (Pillar 1) and a new global minimum tax (Pillar 2). In parallel, the IF SG, a subset of IF countries including the major economies and a representative sample of other countries (e.g. small open economies, developing economies) would work with the OECD Secretariat to hammer out a potential political compromise on Pillar 1, a process that is still ongoing. To this end the Secretariat has put forward the unified approach. Key features are as follows:

- **Nexus:** A threshold, largely based on sales revenue, would be used to determine whether countries have taxing rights over in-scope enterprises. Revenue threshold possibly linked to market size (i.e. GDP). For highly digitalized businesses revenue could be sourced to the location of users (e.g. social media).

The new nexus rule would be 'standalone', i.e. a new treaty article separate from the existing physical presence based permanent establishment (PE) threshold in Article 5 of treaties. The nexus threshold would be applied at the MNE group level, and would require mechanisms to 'trace' supplies through third party intermediaries/platforms.

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.

- **Scope:** Large consumer-facing enterprises are targeted. This could cover sellers of branded goods, franchises, as well as highly digitalized businesses. The precise sectors in scope are yet to be determined, as well as explicit scope exclusions (e.g. extractives, financial services). A size limitation of EUR750m global turnover is mooted in the document, though could differ.
- **Profit allocation:** The profit allocated to markets (including to local subsidiaries) consists of 3 elements, Amounts A, B and C:
 - o Amount A starts with MNE group consolidated accounts. It allocates a share of MNE 'residual profits' (those in excess of 'routine profits') to markets. Simplified metrics are to be used for determining routine profits (e.g. X% of global revenue), the percentage of residual profits allocated to 'the market', and the allocation across market countries (e.g. ratio of sales across countries). In line with a July G7 statement, attention is being given to how the allocation of Amount A to countries could be designed to reflect the intensity of digital/user engagement with a country. The metrics will be determined through negotiation, with the economic analysis of tax revenue effects playing a key role.
 - o Amount B is a floor on the return to 'baseline' physical marketing and distribution activity in the market countries; definition of these activities, and rate, yet to be determined.
 - o Amount C uses standard TP rules to allocate further amounts to the market for functions beyond the Amount B 'baseline'.

Amounts A, B, and C are all noted to need strong dispute mechanisms, possibilities mentioned in the question section being arbitration, ICAP or multilateral APAs. Business line/regional segmentation will be further explored. These profit allocation rules would 'co-exist' with traditional TP rules.

KPMG observations

As noted in our earlier bulletins, the Pillar 1 rules aim to alter the balance of international tax rules. They look to allocate a greater share of taxing rights to market jurisdictions, while still avoiding double non-tax outcomes. IF jurisdictions are being driven towards compromise on this (which many of them would have earlier opposed) by the rising threat of widespread adoption of unilateral measures by countries (e.g. digital service taxes). Whether the new rules increase tax exposures for particular enterprises, and raise their tax burdens, depends on the ultimate design of the nexus, scope and profit attribution rules, as well as their business model and specific circumstances. In the consultation business could:

- Seek clarity on scope rules, for example explicit exclusions for suppliers of goods used by businesses in production activities and vendors of generic/undifferentiated consumer goods.
- Offer views on feasibility of business line/regional segmentation, 'tracing' through intermediaries, and implications for accounting systems, auditing standards, etc.
- Solicit detail on the simplified metrics for Amount A, provide suggestions on Amounts B and C scope, and seek clarity on the double tax relief, losses, disputes and enforcement mechanisms.

Work on the overhaul of international tax rules has now entered the 'details stage'. The proposals set out in the unified approach are the most concrete to-date, even as many details remain to be clarified. While it is still far from assured that the IF jurisdictions will reach consensus in 2020, the November public consultation provides a key opportunity for the business community, including in China, to provide input and express concerns while the rules are still in formation.

In giving their consultation responses on the unified approach, businesses should also consider the parallel impact of the Pillar 2 global minimum tax rules; a public consultation document on this is due out early November, with consultation in December.

In order to best understand the impact of the emerging new rules on tax management, accounting systems, and MNE business and operating structures, close liaison with your KPMG advisor is highly recommended.

并肩赋能 税道渠成

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2019 KPMG Advisory (China) Limited, a wholly foreign owned enterprise in China and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Contact us

National



Lewis Lu

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

Regional Tax Partner-in-charge,
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 Partner
KPMG China
T: +86 (21) 2212 3462
E: benjamin.lu@kpmg.com



John Wang

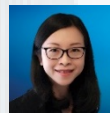
Tax Partner
KPMG China
T: +86 (571) 2803 8088
E: john.wang@kpmg.com

Southern Region



Lilly Li

Partner-in-Charge
National Tax Markets
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

Hong Kong



Alice Leung

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

Management Leaders

National Leader

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

National Tax Markets Leader

Lilly Li
Partner-in-Charge,
KPMG China
+86 (20) 3813 8999
lilly.li@kpmg.com

Regional Leaders

Vincent Pang
Regional Tax Partner-in-Charge,
Northern Region
+86 (10) 8508 7516
vincent.pang@kpmg.com

Karmen Yeung
Regional Tax Partner-in-Charge,
Southern Region
+852 2143 8818
karmen.yeung@kpmg.com

National Tax Operations Leader

Anthony Chau
Partner-in-Charge,
KPMG China
+86 (21) 2212 3206
anthony.chau@kpmg.com

Jennifer Weng
Regional Tax Partner-in-Charge,
Eastern & Western Region
+86 (21) 2212 3431
jennifer.weng@kpmg.com

Curtis Ng
Regional Tax Partner-in-Charge,
Hong Kong
+852 2143 8709
curtis.ng@kpmg.com

Service Lines Leaders

Global Transfer Pricing Services

Xiaoyue Wang
+86 (10) 8508 7090
xiaoyue.wang@kpmg.com

M&A Tax

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

People Services

Murray Sarelius
+852 3927 5671
murray.sarelius@kpmg.com

Trade & Customs

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

Research & Development Tax

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

Tax Dispute Resolution

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

Tax Managed Services

Maggie Mao
+86 (21) 2212 3020
maggie.y.mao@kpmg.com

Tax Transformation & Tax Technology

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

Legal & Indirect Tax

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

International Tax

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

Accounting & Payroll

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

US Corporate Tax

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

Global Compliance Management Services

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

Sector / Market segment Leaders

Auto

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

Financial Services

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

Real Estate

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

US Desk

David Ling
+1 609 874 4381
davidling@kpmg.com

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

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

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

Shirley Shen
+1 669 208 5352
yinghuashen1@kpmg.com

Energy & Natural Resources

Jessica Xie
+86 (10) 8508 7540
jessica.xie@kpmg.com

Enterprise

Karmen Yeung
+852 2143 8818
karmen.yeung@kpmg.com

Domestic Chinese Market

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

Japanese Market

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

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

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

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

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

Technology, Media & Telecommunications

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

Technology, Media & Telecommunications

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

Asset Management Private Equity

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

Korean Market

Henry Kim
+86 (10) 8508 7023
henry.kim@kpmg.com

Operations

China Tax Centre

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

China Tax Centre

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

Learning & Development Tax

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