

# Inclusive Framework BEPS Agreement

## Public Consultation on Pillar One Amount A – February 2022

Policy Perspectives Update – the Hong Kong SAR



### Public consultation on the draft model rules for nexus and revenue sourcing for Amount A under Pillar One

On 4 February 2022, the OECD released the public consultation document entitled “Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing” (“Draft Model Rules”). The document seeks public comments on the first building block (i.e. nexus and revenue sourcing) of Pillar One Amount A and can be accessed via this [link](#).

The Public Consultation Document is structured as a general legislative article that articulates the nexus rules and the sourcing principles at a high level, followed by a schedule (i.e. Schedule A) that sets out detailed rules for assigning each specified category of revenue to market jurisdictions.

A high-level summary of the Draft Model Rules is provided below. For a more detailed discussion of the Draft Model Rules, please refer to our report in this [link](#).

## The nexus test

The nexus test determines whether a market jurisdiction qualifies for the profit re-allocation under Amount A. Consistent with the [October 2021 Statement on the Two-Pillar Solution](#) issued by the OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting, the Draft Model Rules provide that an MNE has sufficient nexus to a market jurisdiction if it derives at least EUR 1 million in revenue in a measurement period (i.e. normally a financial year of the MNE) from that jurisdiction (or at least EUR 250,000 for a jurisdiction with annual GDP less than EUR 40 billion). If the measurement period is not equal to 12 months, the revenue thresholds would be adjusted proportionally.

## The sourcing principles

### Overview

The purpose of the source rules is to ascertain the market in which goods and services are consumed for purposes of determining nexus and apportioning Amount A taxing rights. The Public Consultation Document provides that the sourcing rules have been designed to balance the objective of accurately identifying market jurisdictions and associated revenue while limiting compliance burdens. While the Draft Model Rules retain the same basic architecture as the October 2020 Blueprint on Pillar One, they make significant changes by no longer prescribing a defined hierarchy for the acceptable indicators and, in some cases, allowing revenue to be sourced using specified allocation keys when, after taking “reasonable steps,” an MNE concludes that no “Reliable Indicators” are available.

**KPMG Observation:** While the Draft Model Rules eliminate the strict hierarchy of indicators from the October 2020 Blueprint, it is unclear what “reasonable steps” will be required to obtain information, particularly in a B2B context, or what types of alternative indicators may be used if an identified indicator is not available.

## The transaction-by-transaction approach

An in-scope MNE must source all revenue, generally on a transaction-by-transaction basis, according to the category of revenue earned from the transaction. The Draft Model Rules provide revenue sourcing guidance specific to the following categories of transactions, several of which are further subdivided:

- sales of finished goods;
- sales of digital goods;
- sales of components;
- the provision of services;
- transactions for the licensing, sale, or other alienation of intangible property or user data;
- transactions involving real property;
- government grants; and
- a catchall for non-customer revenue.

Several new rules have been provided to address ambiguity regarding the categorization of a transaction:

- transactions containing elements of multiple categories of revenue are sourced according to their predominant character based on the substance of the transaction;
- “Supplementary Transactions” that are incidental to a “Main Transaction” may be sourced based on the revenue sourcing rule applicable to the Main Transaction; and
- non-customer revenue (such as interest earned other than in a lending business and other non-operating income) is sourced in proportion to the other revenue for which sourcing rules are provided.

### Use of “Reliable Indicators”

Once a transaction has been categorized, revenue is generally required to be sourced according to one of the “Reliable Indicators” identified for the category of revenue. The Draft Model Rules allow an MNE to use any of the listed Reliable Indicators, as well as an unlisted indicator that produces results consistent with the relevant sourcing rule and meets one of the listed reliability tests. An indicator is considered reliable if:

- the MNE relies on the indicator for commercial purposes or to fulfill legal, regulatory or other related obligations;
- the indicator is verified by information provided by a third party that collected the information pursuant to its own commercial, legal, regulatory, or other obligations;
- the indicator and one or more other indicators included in the sourcing rule identify the same jurisdiction, or
- the indicator is verified in another manner that is functionally equivalent to the above tests.

Indicators must be used consistently. Future commentary will provide additional guidance on what is meant by “consistently”.

### Use of “Allocation Keys”

To ensure that an MNE sources all revenue for purposes of Amount A, the Draft Model Rules allow revenue for certain categories of transactions to be sourced according to specified allocation keys. An allocation key may only be used if specifically permitted in the relevant sourcing rule, or if the MNE took “reasonable steps” to identify a Reliable Indicator and concluded that no Reliable Indicator is available.

Future commentary will provide further guidance on what would be regarded as “reasonable steps,” including e.g. where an MNE is unable to obtain reliable indicators by virtue of competition or privacy reasons.

**KPMG Observation:** While the Public Consultation Document indicates that future guidance on “reasonable steps” will consider commercial realities and not impose undue burdens, it is not clear if the cited example of competition or privacy concerns alone will be sufficient, or whether the MNE will be required to request information from its B2B customers.

When permitted in the relevant sourcing rule, the Draft Model Rules provide specific allocation keys for certain transactions and a “Global Allocation Key” that may be used in the absence of a specific allocation key. The Global Allocation Key would deem revenue to arise in each jurisdiction in proportion to its share of final consumption expenditure (as published by the [United Nations Conference on Trade and Development](#)),

except where a jurisdiction is excluded by reason of the “Knock-out Rule.” The Draft Model rules bracket the reference to consumption expenditure and note that other proxies such as GDP are still under consideration for revenue from components and B2B services sold through a reseller.

The Knock-out Rule requires an MNE to eliminate a jurisdiction from the allocation key if the MNE can reasonably assume that revenue did not arise in the jurisdiction. A footnote to the Draft Model Rules indicates that the Knock-out Rule would apply if the MNE has actual knowledge that the good or service is not provided to certain jurisdictions, such as where there is a trade embargo, or the MNE has actual knowledge that the good or service is ultimately consumed in a specific set of jurisdictions, such as where the contract specifies the jurisdictions where the good or service may be used or the customer provides information about the jurisdictions of use.

**KPMG Observation:** The Draft Model Rules are ambiguous on the degree of certainty an MNE must have in applying the Knock-out Rule. While the rule is described as allowing the MNE to make reasonable assumptions, the examples of the scenarios in which the Knock-out Rule would apply indicate that some degree of actual knowledge is required to support the assumption. Hopefully, this will be clarified in the future commentary.

Notwithstanding the above, an allocation key must be used where an MNE:

- used an indicator that is determined not to be a Reliable Indicator by the MNE’s lead tax administration or during the Amount A certainty process and the MNE demonstrates that it does not have any information available to apply a Reliable Indicator;
- demonstrates it does not have information available to apply a Reliable Indicator and no Allocation Key is provided in the relevant sourcing rule; or
- did not take reasonable steps to use a Reliable Indicator.

**KPMG Observation:**

- The Draft Model Rules appear to require the use of an Allocation Key for MNEs that do not take reasonable steps to identify a Reliable Indicator, even if the failure is intentional. While this result would be contrary to the policy objective of the revenue sourcing rules, there would seem to be no alternative in this case. The Draft Model Rules refer to work on the administration of Amount A, including the development of penalties for non-compliance.
- It appears that the lead tax administration for an MNE would be able to determine that the MNE’s use of a particular indicator was not reliable without the need to reach consensus with other tax administrations, although it is not clear whether the MNE would then need to demonstrate that it did not have information to apply a different Reliable Indicator to both the lead and other tax administrations before it could apply an Allocation Key.

## Hong Kong Considerations

According to the October 2021 Statement issued by the IF, only MNEs with global turnover above EUR 20 billion and profitability above 10% will be within the scope of Amount A at the initial stage. Given the high turnover threshold, it is expected that limited number of MNE groups operating in the Hong Kong SAR will be impacted by Amount A. However, the IF has indicated a plan of reducing the turnover threshold to EUR 10 billion. This is contingent on successful implementation and achieving tax certainty on Amount A, with the relevant review beginning 7 years after Pillar One comes into force and the review to be completed in no more than one year.

For those MNE groups that are within the scope of Amount A, the requirement to adopt a transaction-by-transaction basis under the Draft Model Rules (i.e. to categorize each transaction and apply the proper sourcing rule to determine the revenue source of each transaction) represents a significant compliance and administrative burden. The background note to the Draft Model Rules states that the revenue sourcing rules will be supported by detailed record-keeping requirements, based on a systematic-level review of the MNE’s approach to revenue sourcing, without requiring the retention of transaction-level data. An MNE will need to demonstrate that it has clear internal controls on its approach to revenue sourcing, including the data sources. It is expected that these administrative issues will be addressed further in standardized documentation requirements developed in collaboration with tax administrations and businesses. In the

meantime, in-scope MNEs should consider the data sources presently available to comply with the revenue sourcing rules and whether any potential changes are required to business and information management processes.

For in-scope Hong Kong-based MNE groups selling into overseas markets, proper revenue sourcing is not only a compliance requirement under the Draft Model Rules but also an important step to correctly determine the Amount A tax liability, as the domestic corporate income tax (CIT) rates in different market jurisdictions may be different. These groups should also review their current sales / resales flow to different markets in view of the different CIT rates in these market jurisdictions.

In addition, in-scope MNE groups currently making an offshore claim on trading profits for sales to overseas markets and not subject to tax in these overseas market jurisdictions should estimate their potential additional tax costs under Amount A of Pillar One. For in-scope MNE groups currently paying Hong Kong profits tax on trading profits from overseas sales and which will be subject to Amount A tax liability after implementation of Pillar One, they should closely monitor the development of the mechanism for elimination of double taxation under Pillar One.

## What's next

Comments on the public consultation document are due before February 18, 2022. The OECD has not provided a timeline for releasing the commentary on the nexus and revenue sourcing rules.

The IF is expected to release additional working documents in the coming months on the other building blocks of Amount A, with the consultation documents on the tax base, sectoral exclusions, and tax certainty expected in the near term. A public consultation document for Amount B under Pillar One is expected to be issued in mid-2022.

As for Pillar Two, the public consultation on the implementation framework for the GloBE Rules will be launched later this month, with a consultation event to follow in March 2022.

# Contacts

## Global Tax Policy Leadership Group

**David Linke**  
Global Head of Tax & Legal Services  
E: [David.Linke@kpmg.co.uk](mailto:David.Linke@kpmg.co.uk)

**Grant Wardell-Johnson**  
Global Tax Policy Leader and Chair  
E: [Grant.WardellJohnson@kpmg.co.uk](mailto:Grant.WardellJohnson@kpmg.co.uk)

**Manal Corwin**  
Americas Regional Tax Policy Leader  
E: [mcorwin@kpmg.com](mailto:mcorwin@kpmg.com)

**Vinod Kalloe**  
EMA Regional Tax Policy Leader  
E: [kalloe.vinod@kpmg.com](mailto:kalloe.vinod@kpmg.com)

**Conrad Turley**  
Asia Pacific Regional Tax Policy Leader  
E: [conrad.turley@kpmg.com](mailto:conrad.turley@kpmg.com)

**Chris Morgan**  
Responsible Tax Project Leader  
E: [christopher.morgan@kpmg.co.uk](mailto:christopher.morgan@kpmg.co.uk)

## Regional contacts

**John Timpany**  
Head of Tax, Hong Kong SAR  
E: [john.timpany@kpmg.com](mailto:john.timpany@kpmg.com)

**Ivor Morris**  
Hong Kong SAR BEPS 2.0 Project Leader  
E: [ivor.morris@kpmg.com](mailto:ivor.morris@kpmg.com)

**Anita Tsang**  
Director, Tax Policy and Knowledge  
Management  
E: [anita.tsang@kpmg.com](mailto:anita.tsang@kpmg.com)

[kpmg.com/cn/socialmedia](https://kpmg.com/cn/socialmedia)



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.

© 2022 KPMG Tax Services Limited, a Hong Kong (SAR) limited liability company and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organisation.