

Inclusive Framework BEPS Agreement

Public Consultation on Pillar One Amount A – March 2022

Policy Perspectives Update – the Hong Kong SAR



Public consultation on the draft model rules for tax base determination for Amount A under Pillar One

On 18 February 2022, the OECD published another public consultation document on Pillar One Amount A. The document contains the **draft model rules for tax base determination under Amount A** and can be accessed via this [link](#). The first consultation document on Amount A was published on 4 February 2022 and set out the draft model rules on nexus and revenue sourcing. For more details, please refer to our Hong Kong BEPS publication issued in February 2022 in this [link](#).

Similar to the consultation document on nexus and revenue sourcing, this consultation document is structured as a general legislative article that articulates the tax base determination rules at a high level, with the detailed practical application of the rules to be elaborated in the Commentaries to follow.

Amount A will initially be applied to multinational enterprise (MNE) groups with annual consolidated revenue exceeding EUR 20 billion and profitability above 10%.

Summary of the rules

The draft model rules on tax base determination set out how to compute the profit (or loss) before tax of an in-scope MNE group that will be used for the Amount A calculation purpose (i.e. Amount A tax base). Amount A tax base is another important building block of Amount A as it will form the basis for determining the amount of profits that are subject to reallocation to the market jurisdictions.

Adjusted profit (loss) before tax

- The adjusted profit (or loss) before tax will be calculated based on the consolidated financial accounts of the ultimate parent entity, with a limited number of book-to-tax adjustments.
- The starting point will be the bottom line figure of the consolidated P&L statement (i.e. the total profit or loss), with a number of adjustments to arrive at the “Adjusted Profit Before Tax” amount.
- The adjustments allowed/required for this purpose are not as extensive as those that apply under the GloBE Model Rules for Pillar 2 – the global minimum tax rate initiative. Broadly, the items that need to be excluded are:
 - current and deferred income tax expense (income);
 - dividend income;
 - gains or losses arising from the disposal of an equity interest in another entity, or from a change in the fair value of such interest;
 - profits or losses arising under the equity method of accounting, except those from a joint venture where the MNE group has joint control; and
 - policy disallowed expenses (e.g. fines, penalties or any illegal payments).
- The document indicates that further consideration will be given on whether gains and losses associated with the disposition of equity interest from controlling interests should be excluded. There is no

adjustment in the draft model rules for gains or losses from the sale of assets that are not equity interests in other entities. The OECD is inviting comments on whether this differentiation is appropriate.

Restatements

- Restatements of profit (or loss) in the financial accounts of prior periods are generally attributed to the Amount A tax base in the period the restatement is identified and recognised by an MNE group.
- However, the “Total Eligible Restatement Adjustment” for a period is limited to 0.5% of the revenue of the MNE group in that period, and any excess can be carried forward.

Carry forward of losses

- Unrelieved losses from prior years can generally be carried forward and deducted in the calculation of the Adjusted Profit Before Tax in the current year, subject to the following tentative time limitations that are still under discussion:
 - a limitation on the number of years an MNE group can carry forward the losses (both post and pre-regime losses) - currently proposed to be no more than between 5 and 15 calendar years prior to the current period; and
 - a limitation for an MNE group to recognise the losses incurred in years prior to the introduction of Amount A - currently proposed to be no more than between 2 and 8 calendar years prior to the commencement date of Amount A.
- The draft model rules also provide for how to deal with losses in the context of certain mergers and demergers. There are provisions for losses of a standalone entity, or of a group that is wholly acquired, to transfer to the acquiring MNE group. Interestingly, it seems that in the case of the acquisition of only part of a group, the losses would remain with the vendor group.
- The tax base rules for in-scope MNE groups that are subject to segmentation for Amount A purpose are not included in the model rules and will be released later.

What's next

The draft model rules are released for public comments and do not reflect the final views of the members of the OECD Inclusive Framework on BEPS. Further changes to the model rules may be made. Interest parties are invited to submit their comments before 4 March 2022.

In addition to the nexus and sourcing rules and the tax base determinations rules, other important building blocks of Amount A that are more relevant to the businesses in Hong Kong include: exclusion for regulated financial services, tax certainty for Amount A, elimination of double taxation, marketing and distribution profits safe harbor, administration and roll-back of unilateral measures. It is expected that the OECD will release the public consultation documents on the other building blocks of Amount A on a rolling basis in the coming months.

For Amount B, the public consultation is scheduled to take place in mid-2022, with the work on Amount B to be finalized by the end of 2022.

In-scope large MNE groups in Hong Kong should closely monitor the developments in this area in the coming few months and consider taking the opportunity of the OECD's public consultation to voice out their concerns and submit their recommendations.

Contacts

Global Tax Policy Leadership Group

David Linke
Global Head of Tax & Legal Services
E: David.Linke@kpmg.co.uk

Grant Wardell-Johnson
Global Tax Policy Leader and Chair
E: Grant.WardellJohnson@kpmg.co.uk

Manal Corwin
Americas Regional Tax Policy Leader
E: mcorwin@kpmg.com

Vinod Kalloe
EMA Regional Tax Policy Leader
E: kalloe.vinod@kpmg.com

Conrad Turley
Asia Pacific Regional Tax Policy Leader
E: conrad.turley@kpmg.com

Chris Morgan
Responsible Tax Project Leader
E: christopher.morgan@kpmg.co.uk

Regional contacts

John Timpany
Head of Tax, Hong Kong SAR
E: john.timpany@kpmg.com

Ivor Morris
Hong Kong SAR BEPS 2.0 Project Leader
E: ivor.morris@kpmg.com

Anita Tsang
Director, Tax Policy and Knowledge
Management
E: anita.tsang@kpmg.com

kpmg.com/cn/socialmedia



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